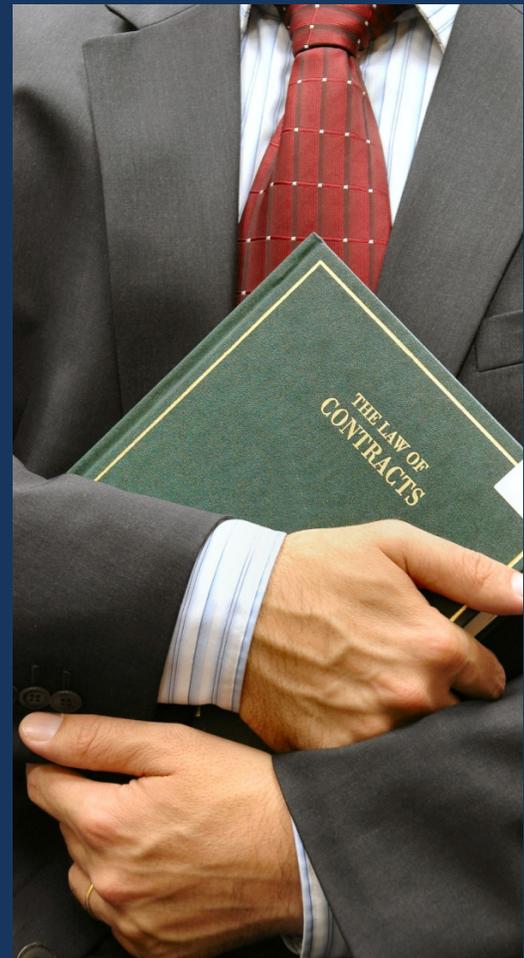




Contracting for Forest Carbon:

Elements of a Model Forest Carbon Purchase Agreement



the
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Contracting for Forest Carbon: Elements of a Model Forest Carbon Purchase Agreement

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A joint project of Duke Law School and the Nicholas School of the Environment, the Environmental Law and Policy Clinic operates as a live client clinic out of offices in the Duke Law School building in Durham, N.C. Students work under direct supervision of Clinic Director Ryke Longest and Supervising Attorney Michelle Nowlin. Longest worked for fourteen years as an environmental enforcement attorney for the North Carolina Department of Justice prior to coming to Duke. Nowlin is a joint-degree graduate from Duke Law School and the Nicholas School, and worked for the Southern Environmental Law Center in Chapel Hill for 13 years prior to returning to Duke.

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Forest Trends' mission is to maintain, restore, and enhance forests and connected natural ecosystems, life-sustaining processes, by promoting incentives stemming from a broad range of ecosystem services and products. Specifically, Forest Trends seeks to catalyze the development of integrated carbon, water, and biodiversity incentives that deliver real conservation outcomes and benefits to local communities and other stewards of our natural resources.

Forest Trends analyzes strategic market and policy issues, catalyzes connections between producers, communities and investors, and develops new financial tools to help markets work for conservation and people.

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The Katoomba Group, part of the Forest Trends Family of initiatives, is an international network of individuals working to improve capacity related to incentives for ecosystem services and products.

The Katoomba Group's Legal Initiative works to clarify legal issues and address technical gaps by (1) developing country-specific legal and policy information, (2) creating and sharing transactional tools, and (3) providing capacity-building around legal issues.

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- the CERSPA document, available at www.cerspa.com,
- the International Emissions Trading Association Emissions Trading Master Agreement for the EU Scheme, available at <http://www.ieta.org/ieta/www/pages/getfile.php?docID=194>,
- and template contracts for ecosystem services transactions developed by Mark Ellis-Jones of CARE International, available at www.katoombagroup.org/legal_contracts.

As part of a suite of publications on carbon markets and transactions, this report complements other Forest Trends publications, including the annual *State of the Voluntary Carbon Market* and *State of the Forest Carbon Markets* reports, and how-to manuals, such as: *Getting Started with Payments for Ecosystem Services* and the forthcoming *Step-by-Step Guide to Forest Carbon Projects*. We urge readers to refer to these publications for additional information and guidance.

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This report and the featured sample agreement are meant to provide a general introduction to contracting for forest carbon credits and are not intended to be legal advice. The sample contract clauses are illustrative only, and should not be used without significant additions and customization, as relevant to the particular circumstances of the transaction.

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Introduction

Forest carbon has the potential to play an important role in climate mitigation. Scientists assert that deforestation and degradation account for 15% to 20% of CO₂ emissions.¹ Other reports, including *The Stern Review*, *The Eliasch Review*, and research by McKinsey and Company, support the halting of deforestation as a critical and cost-effective means of reducing global greenhouse gas (GHG) emissions.²

Forest carbon payments – payments for restoring or planting forest, or for preventing forest degradation or deforestation – can help to prevent and reverse forest loss. However, forest carbon transactions today raise many challenging issues for participants, including difficult legal questions. Despite almost twenty years of transacting forest carbon, and more than 67.8 million tons of carbon dioxide transacted,³ transaction costs and legal fees remain significant and unpredictable.

In addition, the nature of forest carbon markets is such that buyers and sellers are likely to be on unequal footing in terms of their financial resources and commercial experience. Forest carbon sellers tend to be landowners and may have little experience with commercial transactions, whereas forest carbon buyers are generally economically sophisticated companies and carbon brokers.

¹ Solomon, S. et al. 2007; van der Werf, G. et al. 2009; Rogner, H. & Dadi Zhou et al. 2007.

² Stern, N. 2006; Eliasch, J. 2008; Enkvist, P. et al. 2007.

³ Hamilton, K. et al. 2010.

Box 1. Types of Forest Carbon Projects

Different activities can form the basis of a forest carbon project, including:

- **Afforestation** – planting and raising trees in areas that were not forested in recent history.
- **Reforestation** – planting and raising forest in areas that were forested in recent history.
- **Improved forest management (IFM)** – engaging in land management activities that enhance carbon stocks in forest.
- **Reducing emissions from deforestation and degradation (REDD)** – protecting existing forests from degradation or deforestation that would otherwise occur, thereby avoiding carbon emissions.
- **REDD+ or REDD++** – according to the United Nations REDD Program, “REDD+ goes beyond deforestation and forest degradation and includes the role of conservation, sustainable management of forests, and enhancement of forest carbon stocks.”⁴ REDD++ refers to a broader suite of land-use activities, including things like agriculture, and land management.

In order to lower legal costs of forest carbon transactions and help to level the playing field between buyers and sellers, this document guides the reader through a sample forest carbon emission reductions purchase agreement (ERPA). The discussion outlines issues that arise during pre-negotiation, negotiation, and contracting, while sample contract clauses illustrate the discussion and provide examples of relevant contractual language.

⁴ UN-REDD Programme 2010.

Legal costs make up a significant, and often overlooked, share of forest carbon transaction costs. By providing readers – whether sellers, buyers, lawyers, or other stakeholders – with an understanding of forest carbon legal issues, as well as a basic familiarity with contractual language, this document can help to reduce these costs.

Box 2. Emission Reductions and Verified Emission Reductions

Emission reductions (ERs) represent net carbon (or CO₂ equivalent) emission reductions or additional carbon storage, in tons, due to a forest carbon project.

Successful validation and verification of emission reductions to an external standard – for example, the Voluntary Carbon Standard – transforms ERs into verified emission reductions (VERs), a marketable commodity.

The sample agreement in this document involves multiple sellers, represented in the agreement by a single individual, and a forward purchase of VERs on the voluntary carbon market. “Forward” refers to the fact that parties agree to the purchase and sale of VERs that have not yet been created.

A forward emission reductions purchase agreement is by no means the only way to structure investments in forest carbon projects. Another option is to use private equity financing to give the investor some rights to eventual revenues, and possibly a degree of control over project activities, in return for early-stage investment. At the other end of the project cycle, a buyer may make a “spot” purchase of VERs that have already been generated and issued, virtually eliminating the buyer’s exposure to project risks and allowing the seller to ask for a higher price per VER. Different investment and purchase options involve trade-offs between price, risk, level of control, and other factors.

This document discusses a forward sale of VERs as opposed to some other investment or purchase agreement for several reasons. First, the forward sale tends to be an attractive option for forest carbon sellers that need up-front financing, help with project costs, and/or sharing of project risks with an investor or buyer. Second, an emission reductions purchase agreement can be relatively standardized, yet remain customizable for specific transactions, making it well-suited for use in a guidance document such as this one. Third, forward purchase agreements raise forest-carbon-specific issues related to project activities, advance payments, default and remedies clauses, and other issues, in a way that spot purchase agreements, for example, do not. This type of agreement therefore provides a good framework for discussing negotiation and contracting issues that are in some way unique or specific to forest carbon.

While the authors have made every effort to ensure that the information provided is relevant to forest carbon project participants generally, different issues will arise in every case. Readers therefore should not rely upon the information provided here for legal advice, but should seek out experienced legal support appropriate to their particular circumstances.

Introducing the Transaction and the Parties

Title, Introduction, and Recitals

The forest carbon agreement will have a title, which should be simple but descriptive but need not include the names of the parties. The introduction follows, in the form of a short paragraph identifying the parties and the date of the agreement. The principal, legal, or registered addresses of the parties are generally listed here. The date of the contract should ideally be the date of signing for the last party to sign the agreement.

Next come the recitals, which include any background information that the parties think is relevant. Recitals may include a description of the goals of the agreement along with background information about the project, the parties, and any relevant agreements between the parties or any party and one or more third parties. The recitals should not contain any binding obligations.

The introductory part of the agreement ends with a lead-in sentence indicating that “the parties agree as follows,” as shown in Box 1.

Box 1. Sample Beginning of an Agreement

FOREST CARBON EMISSION REDUCTIONS PURCHASE AGREEMENT

This forest carbon emission reductions purchase agreement is dated _____, and is between Seller Representative Assn., a Brazilian non-profit association (the “**Seller Representative**”), and Investor Corp., a Delaware corporation (the “**Buyer**”).

RECITALS

The Seller Representative and participating members of the Ecosystem Service Provider Community (“**Participating Landholders**”) are party to an agreement dated _____, concerning the authority of the Seller Representative to represent the Participating Landholders with respect to forest carbon transactions on land under the control of the Participating Landholders.

Participating Landholders wish to undertake land management activities in order to reduce emissions from deforestation and degradation and enhance carbon sequestration in forests under their control (the “**Project**”).

The Buyer wishes to pay Participating Landholders for the right to claim credit for emission reductions or additional sequestration generated by the land management activities of Participating Landholders.

The parties therefore agree as follows:

Parties

In its simplest form, a purchase agreement is between two parties: a buyer and a seller. A forest carbon purchase transaction, however, may involve multiple sellers – perhaps even whole communities – and multiple buyers. Generally speaking, the more parties are involved, the higher the administrative and transaction costs will be. The additional cost, and potential risk, can and should be mitigated by the use of one or more intermediary entities to: (1) represent the sellers as a collective unit in negotiating with third parties, including buyers, (2) oversee project development and governance, and (3) manage collection and disbursement of revenues.

Where multiple sellers are involved, sellers should ideally agree to be represented by a single

individual or entity – a sellers’ representative – who will be authorized to negotiate with buyers and any third parties involved in the project on behalf of the sellers as a group. Different jurisdictions are likely to have distinct legal requirements for authorizing a third party to act on behalf of sellers. Accordingly, sellers will have to consult local counsel to ensure compliance with the law.

Potential buyers will verify the capacity and authority of the sellers’ representative as part of the due diligence process, in order to avoid potential disputes over authorization that can disrupt project activities. Buyers may also need assurances that they are dealing with a valid, authorized entity so as not to violate anti money-laundering laws in their home country.

The sellers’ representative may also be entrusted with leading project development and design, as well as project governance once the project is up and running. The sample agreement assumes that the project is already underway. Therefore, it deals with project governance but not project development.

Good, transparent project governance, with robust procedures in place to resolve disputes and facilitate participatory collective decision-making, can be expected to reduce the cost to sellers of administering the project and to contribute to the project’s success. Project governance provisions should be agreed on by all sellers in advance, and entrusted to a single individual or entity to ensure that they are carried out as agreed.

In addition, the sellers’ representative may be authorized to collect revenues from buyers and disburse funds to sellers according to agreed procedures. Alternatively, this role may be granted to a separate entity – a trust fund, for example – that will be in charge of funds management.

Procedures for seller representation, project governance, and funds management must be

agreed in advance between all sellers, the sellers’ representative and any other participating entities, and outlined in one or more written agreements. For the sake of simplicity, the sample purchase agreement described in this document assumes that the sellers’ representative is properly authorized in a single agreement with all sellers to both negotiate on behalf of the sellers (“Participating Landholders” in the sample agreement), as well as to oversee project governance and manage project funds.

On the buyer side, the sample purchase agreement considers a single buyer. It is recommended that sellers execute a separate purchase agreement with each buyer.

In some cases, the government may participate in forest carbon projects as a buyer or a seller. Such government involvement will raise unique issues that are not addressed in this document but will be essential to address in the development of successful agreements.

The Body of the Agreement: Rights and Responsibilities

The Project

Forest carbon sellers can generate net emission reductions by: (1) reducing forest emissions from deforestation and degradation and (2) increasing the amount of carbon stored in forests via reforestation, restoration, or improved forest management.

Emission reductions, however, do not become readily marketable commodities until they are validated and verified to an external standard and become verified emission reductions (VER). In theory, any VER that is verified to a certain standard is equivalent to any other VER verified to that standard, regardless of how it was created. This approach provides the basis for trading VER on carbon markets. In practice however, VERs will sell for different prices

depending upon where the project is located and other circumstances. For example, a VER from a community-based forest carbon project can be sold at a higher price than a VER from a project that reduces methane emissions from landfills.

VER may either be sold after they are created – in a ‘spot’ sale – or they may be sold ahead of time in a ‘forward’ sale. The spot price for VER is substantially higher than the forward price, because the buyer bears no project risk. On the other hand, sellers may prefer forward sales, which provide up-front funding for project activities. In a forward purchase agreement, project activities are a central concern: the seller promises to diligently perform activities in order to maximize the chance that the project will ultimately create credits.

Due to the desirability (and often necessity) of a forward sale from a seller’s point of view, in terms of providing funds for project development and sharing project risks, this document focuses on a forward sale of VERs. Project activities therefore appear at the beginning of the body of the agreement.

Box 2. Sample Clauses Dealing with Forest Carbon Project Activities

Article 1. *Sale and Purchase; Project Activities.*

1.1 *Sale and Purchase.* The Seller Representative agrees to sell and the Buyer agrees to purchase verified emission reductions (“VERs”) subject to and in accordance with the terms of this agreement.

1.2 *Project Activities.* Participating Landholders shall manage their land and forest in order to decrease greenhouse gas emissions from deforestation and degradation and increase carbon sequestration (“**Project Activities**”) in accordance with the project plan in annex 1 (the “**Project Plan**”).

1.3 *Project Area.* The land on which the Project Activities will occur (the “**Project Area**”) is the area that is described in annex 2.

1.4 *Mitigation of Risk.* Participating Landholders shall manage the Project Area to reduce the risk of forest loss due to fire, insects, or plant disease as provided in the Project Plan.

1.5 *Project Governance.* The Seller Representative shall oversee governance of the Project and shall ensure compliance with the project governance procedures in the Project Plan.

1.6 *Effective Date, Term.* This agreement takes effect upon execution by both parties (the “**Effective Date**”) and remains in effect until delivery of all VERs covered by this agreement or the earlier termination of this agreement in accordance with its terms.

In the forest carbon context, there is a real danger that a forest fire, insect infestation, or plant disease outbreak could cause the release of stored carbon and destroy the transaction. Clause 1.4 assures the buyer that the landholders will take certain actions to mitigate the risk of forest fire, insect infestation, or plant disease outbreak, as specified in the Project Plan. This clause is important because the landholders can mitigate such risks, but not eliminate them entirely. For example, sellers can plant mixed tree species, maintain distances between mature trees, and clear dead brush, as appropriate to the forest ecosystem in which the project is situated.

The project governance procedures referred to in clause 1.5 must be agreed among all participating landholders and the sellers’ representative and should include protocol for decision-making among participating landholders, distribution of revenues, transparency, and other project governance matters. Important goals of that document include: assurance that there is ongoing free,

prior, and informed consent by all participants; provision for a fair allocation of revenues; and an orderly division of responsibility among participants.

Project governance procedures should also provide for how, if at all, new participating landholders may join the project after it commences. Care should be taken to disallow participation by people who have gained rights in land illegitimately, by coercion, or by force. It will also be important to adjust benefit-sharing appropriately if different landholders participate in project activities for different periods of time.

Delivery

In any purchase agreement, the seller is obligated to deliver purchased goods or services to the buyer. Since forest carbon sequestration occurs over long periods of time, delivery of VERs will often occur over a 15-30 year period from the start of project activities.

The sample agreement illustrates one common delivery arrangement for a forward carbon purchase, that is regular deliveries of all or a portion of the VERs generated by the project for the duration of the agreement. This approach recognizes fundamental uncertainties in the timing and amount of VERs that will be generated by a forest carbon project.

Delivery of VERs generally occurs over an electronic registry that tracks transfers of VER and helps to ensure that no double-counting of emission reductions occurs. Responsibility for opening and maintaining a registry account, and paying transfer or other fees, should be allocated in the agreement.

Box 3. Sample Delivery Clause

Article 2. *Delivery of Verified Emission Reductions*

2.1 *Delivery and Acceptance.* On June 1, 2012 and each June 1 thereafter (the “**Delivery Date**”) through June 1, 2026 (the “**Agreement Term**”), the Seller Representative shall deliver, and the Buyer shall accept, all of the VERs issued to the Project during the preceding year from June 1 to May 31, inclusive (each such delivery and acceptance, a “**Transaction**”).

2.2 *Registry.* The Seller Representative shall deliver VERs on the Markit VCS Registry or such other registry as is agreed in writing between the parties (the “**Registry**”).

2.3 *Costs.* Each party shall pay its own costs of opening and maintaining a registry account. The Buyer shall pay all transfer and other fees assessed by the Registry.

2.4 *No Encumbrance.* The Seller Representative shall not create or permit to exist any claim or encumbrance over the Emission Reductions or the VER that are the subject of this agreement.

Price and Payment

The buyer’s primary obligation is to make payments in return for VERs from project activities. In turn, the seller must transfer all legal rights in the VERs to the buyer. This transfer of rights is meant to ensure that the seller cannot re-sell the same VER to a different buyer. It also provides security for the seller, because rights in the VER are only transferred once full payment occurs (see Box 4, clause 3.8).

One of the most difficult aspects of forest carbon transactions involves the question of up-front payments. An emission reductions purchase agreement, like the sample agreement, anticipates that most of the payment is due upon delivery of VER. However, many forest carbon sellers, and small-scale sellers in particular, need payment up front – in the form

of advance payments – in order to fund project activities.

Because the buyer bears more risk by paying in advance, he or she is likely to require a discounted price and/or an increase in control over project activities if advance payments are used.

In terms of the price for VERs, the parties may use a fixed price or they may tie the price to an index that accounts for price fluctuations over time. A fixed price is more commonly used.

The downside of using a fixed price is that the parties cannot be sure until VERs are issued whether they made a good deal, relative to the spot price for VERs. The parties can limit this uncertainty by providing that the seller will share in profits when the spot price rises above, or in losses when the spot price falls below, a set threshold. This helps to reduce or eliminate the incentive for one party to break the contract due to a wide discrepancy between the spot price and the contract price.

Alternatively the parties can maintain their relative position at all times by using an indexed price, which takes price fluctuation into account by tying the price of VERs to an external index such as the Bloomberg New Energy Finance Voluntary Carbon Index. The downside of an indexed price is that there is uncertain pricing until VERs are issued, which creates significant risk for both parties. If an indexed price is used, a minimum price (a floor) and/or a maximum price (a ceiling) may be used to limit price uncertainty.

Regardless of how the price is determined, the sellers must release all claims to VERs when payment is delivered for those VERs, and not before. Doing so establishes a sort of lien on VERs that is released only by full payment.

Box 4. Sample Price and Payment Clauses

Article 3. *Payments.*

3.1 *Price.* The **Contract Price** is U.S. \$5 per VER delivered under this agreement.

3.2 *Statement.* As soon as practicable after the Delivery Date for a Transaction, the Seller Representative shall send to the Buyer a written statement (the "**Statement**") showing for such Transaction:

- (a) the quantity of VERs delivered;
- (b) the Contract Price;
- (c) the date of delivery;
- (d) any amount owing from one party to the other;
- (e) the net amount payable from one party to the other after taking into account all of the above (the "**Statement Amount**"); and
- (f) any applicable amount payable under clause 4.1 (*VAT Taxes*) as a result of transfers under this agreement.

3.3 *Failure to Issue Statement.* If the Seller Representative fails to issue a Statement in accordance with clause (Statement), then the Buyer may issue that Statement to the Seller Representative and, once issued, that Statement shall be treated as a Statement issued by the Seller for the purposes of this agreement. Failure to issue a Statement does not affect the rights and obligations of the parties under this agreement and is not an Event of Default as that term is defined in clause 9.1.

3.4 *Payment Due Date.* The **Payment Due Date** is the fifth Banking Day after the later of: (i) the Delivery Date and (ii) the date on which the Statement is delivered to the buyer in accordance with clause (Statement).

3.5 *Payment Mechanics*. On or before the Payment Due Date, the Buyer shall transfer the Statement Amount, plus any amounts payable to the Seller Representative under clause (VAT Taxes) and 4.2 (Other Taxes), in US Dollars and by direct bank transfer or equivalent transfer of immediately-available funds, into the account specified in Annex 3.

3.6 *Advance Payments*. The Buyer shall make advance payments according to the Advance Payment Schedule in (“**Advance Payments**”). Advance Payments directly offset the Buyer’s payment liability for delivered VERs.

3.7 *Sufficient Funds*. The Buyer shall maintain sufficient funds to fulfill its obligations under this agreement, and shall make audited financial reports available to the Seller Representative upon the Seller Representative’s reasonable request.

3.8 *Transfer of Title*. No property interest in the VERs will pass to the Buyer until delivery and payment are complete in accordance with the terms of this agreement. Upon such completion, all rights, title and interest in and to the VERs, will transfer to the Buyer. Transfer of VERs does not transfer eligibility for tax credits or other direct third-party subsidies for the operation of the Project.

These sample price and payment clauses, however, represent only one simplified way of dealing with the issues described above, and they omit several additional issues entirely. Omitted issues, including the three discussed below, can add substantial complexity if used.

First, payments in-kind, in the form of equipment, raw materials, technology, or training, may be desirable for both the buyer and the seller. The form, feasibility, and valuation of in-kind payments depend entirely upon the circumstances.

Second, particularly where the project involves complex payouts to various sellers and supporting entities, or significant prepayment by the buyer, it is common to use an escrow account to transfer payments for VER from the buyer to the seller. Procedures for disbursement of funds from the escrow account would be outlined in a separate agreement between the account holder (a financial institution), and sellers and supporting entities, if applicable, and must be in accordance with project governance and benefit sharing arrangements.

Third, if sellers are concerned about the risk that the buyer will not have the money to pay when required, sellers can require the buyer to maintain a letter of credit, or sufficient funds, or some other form of performance assurance. However, performance assurance can be expensive and may be hotly contested.

Taxes

The agreement must address which party is responsible for taxes assessed in connection with the agreement. One common tax that must be addressed is the value-added tax (VAT), which is charged when a good or service is transferred and is based on the value of the good or service.

The sample agreement provides that the buyer is responsible for paying VAT. If VAT is chargeable to the sellers’ representative, then the buyer must pay the sellers’ representative the value of the tax. Note that where a “Reverse Charge Rule” is part of the VAT law in the buyer’s country, the buyer is responsible for calculating and paying VAT directly to the foreign government entity that charges the tax and therefore need not pay the sellers’ representative.

Box 5. Sample VAT and Other Tax Clauses

Article 4. *Taxes*

4.1 *VAT Taxes*. All amounts referred to in this agreement are exclusive of any value-added taxes (“VAT”) properly chargeable on goods or services transferred under this agreement.

(a) VAT applicability and treatment will be determined pursuant to the law of the jurisdiction where a transfer subject to VAT is deemed to take place.

(b) On the Payment Due Date, the Buyer shall pay to the Seller Representative an amount equal to the VAT, if any, properly chargeable in the Seller Representative's jurisdiction for transfers under this agreement; provided, however, that (i) such amount need not be paid until the Seller Representative provides the Buyer with a valid VAT invoice in relation to that amount and, (ii) the Buyer is under no obligation to make any payment to the Seller Representative in respect of VAT which the Buyer must self-assess and pay under the “reverse charge” rule or any similar system in the Buyer's jurisdiction.

(c) Each party shall, to the extent permitted by law, provide the other with any additional valid VAT invoices as required for the purposes of this agreement and, to the extent required by law, shall correctly account for any VAT properly due in its jurisdiction.

4.2 *Other Taxes*.

(a) Subject to each party's obligations relating to VAT, each party shall cause all royalties, taxes, duties and other sums (including any stamp duty, other documentary taxes, climate change levy or other environmental tax or levy) legally payable by that party arising in connection with this agreement to be paid.

(b) In the event that the Seller Representative is required by law to pay any tax which is properly for the account of the Buyer, the Buyer shall promptly indemnify or reimburse the Seller Representative in respect of such tax. In the event that the Buyer is required by law to pay any tax which is properly for the account of the Seller Representative, the Buyer may deduct the amount of any such tax from the sums due to the Seller Representative under this agreement and the Seller Representative shall promptly indemnify or reimburse the Buyer in respect of any such tax not so deducted.

In the sample agreement, taxes other than the VAT are allocated to the party to whom they are properly chargeable. This is a simple solution, though many will prefer to negotiate a different allocation of taxes and other costs.

Representations

Representations are statements of fact that are made by each party to an agreement in order to remove uncertainties and induce the other party or parties to enter the transaction. For example, each party typically represents that it is legally authorized to enter into, and perform its obligations under, an agreement. Representations should be limited to statements of fact, and should not contain forward-looking statements or obligations (which are usually referred to as “covenants” and dealt with separately).

In a project involving multiple sellers, the sellers may want to represent that the project's governance mechanisms facilitate full, prior, and informed consent, enhance transparency or equity, or increase the likelihood of project success.

If a party's representations turn out not to have been true when made – known as a failure of that party's representations – then the other party will have rights and remedies as specified

in the agreement (see Box 11 - *Default* and Box 12 - *Remedies*).

A partial list of general representations (made by each party) appear in Box 8.

Box 6. Sample General Representations

Article 5. *Representations.*

5.1 *General Representations.* Each party represents that:

(a) It is duly organized and validly existing under the laws of the jurisdiction of its organization or incorporation, and, if relevant under those laws, in good standing.

(b) It has the power:

(1) to execute this agreement and any other documentation to which it is a party relating to this agreement;

(2) to deliver this agreement and any documentation relating to this agreement that it is required by this agreement to deliver; and

(3) to perform its obligations under this agreement,

(c) All required authorizations have been obtained and are in full force and effect.

(d) Execution, delivery, and performance under this agreement does not cause it to violate any applicable law, statute, contractual obligation, or court or government order.

(e) Its obligations under this agreement are legal, valid, and binding, and enforceable in accordance with their respective terms, subject to applicable creditors' rights laws and to equitable principles of general application.

(f) No Event of Default, as that term is defined in Article 9, or event that with notice or lapse of time or both would constitute an Event of Default, has occurred with respect to it, and no such event would occur as a result of its entering into or performing its obligations under this agreement.

(g) No litigation, arbitration, or administrative proceeding before any governmental entity is pending or, so far as it is aware, threatened against it that would, if adversely determined, result in a material adverse change in its financial condition or its ability to perform its obligations under this agreement, or that is likely to affect the legality, validity, or enforceability against it of this agreement.

(h) It has entered into this agreement after a full opportunity to review its terms and conditions, it has a full understanding of these terms and conditions and their risks, and it is capable of assuming those risks.

(i) It is not relying upon any representations of the other party other than those expressly set out in this agreement, and the other party is not acting as a fiduciary or advisor for it.

(j) All information that is identified as being subject to or connected with this agreement and that it provides, or that is provided on its behalf, in writing to the other party is, as of the date it is provided, true, accurate, and complete in every material respect.

Forest carbon sellers may need to make additional representations to the effect that sellers are legally entitled to sell VERs from the project area under applicable local and national law. Furthermore, if a seller's representative is used, it should represent that it was legally appointed, after full and fair disclosure, by all participating landholders.

Box 7. Sample Representations Made by the Sellers' Representative

5.2 *Seller Representative Representations.* The Seller Representative represents that:

(a) Participating Landholders hold use rights in the Project Area, as shown in the land use grant that is attached at annex 4, that entitle them to perform, and receive revenue from, Project Activities.

(b) As shown in the agreement between the Seller Representative and Participating Landholders that is attached at annex 5, the Seller Representative is authorized by the unanimous, free, prior, and informed consent of Participating Landholders to act on behalf of Participating Landholders and to oversee project governance and distribution of revenues as described in the Project Plan.

To show the buyer that sellers are legally entitled to sell VER from their land, sellers must, at a minimum, demonstrate that:

- Sellers have a use right (statutory or customary) in the project area that permits them to perform project activities and exclude incompatible uses, for the full duration required by the purchase agreement and the certification standards used.
- Claiming and transferring credit for emission reductions within the project area is not contrary to applicable national or local law.

If the land or natural resources belong to the government, governmental approval may be required for project activities to proceed.

It may be good practice to specify that participating landholders have held use rights for a minimum period of time before the project began, indicating that they did not recently acquire rights in the project area by squatting or appropriation.

The function of clause 5.2(a) in Box 9 is to assure buyers that the sellers' representative has the free, prior, and informed consent of all participating landholders to (1) represent participating landholders, (2) oversee project governance, and (3) manage revenue distribution. The sellers' representative will need to attach proof of consent, which can be an agreement signed by all participating

landholders and the sellers' representative, to the purchase agreement.

Validation and Verification

Using the Voluntary Carbon Standard or another accepted standard or program for assessing the carbon benefits of a forest carbon transaction provides minimum requirements and procedures for project validation and verification. Most standards, including the Voluntary Carbon Standard, additionally provide specific methodologies or protocols that describe how the project and its net effects on carbon emissions are to be assessed in specific circumstances. For the sake of simplicity, this document will use “**standards**” to refer to carbon standards or programs and “**methodologies**” to refer to methodologies or protocols under those standards.

Generally, **validation** is an evaluation of the project plan and associated documents to determine whether the project is likely to generate emission reductions that can satisfy the requirements of the chosen standard and methodology. **Monitoring** refers to periodic assessments of whether the project is accomplishing its goals. **Verification** refers to an ex-post evaluation of whether emission reductions were generated as planned.

Even in the voluntary market, rigorous third party validation and verification is likely to be extremely important to buyers. Where third party validation and verification is used, the purchase agreement must specify which standard, and which of the chosen standard's methodologies, will be used. Alternatively, the agreement can describe the process by which a standard and methodology will be selected.

In general, validation and verification must be done by separate individuals or entities, each of which must be approved to perform accreditation under the chosen standard. Due to both the rigor required and the lack of people

qualified to perform validation and verification, the time and expense involved is significant and unexpected delays are common. These and other costs and risks of validation and verification must be allocated in the purchase agreement.

When VERs have been validated and verified to a certain standard, they are “issued” by the standards organization and entered into a carbon credit registry that tracks the issuance and ownership of VERs.

Who will bear the costs of validation, verification, issuance, and registration is likely to be a major issue in a purchase agreement. Assumption of some of these costs by the buyer provides a major incentive for sellers to use a forward purchase agreement – rather than selling for a higher price on the spot market at a later time.

To account for changing circumstances, the purchase agreement should contain a process for changing the chosen standard and methodology in order to allow the parties to adapt. For example, new national law or international treaty may require or prefer a different standard for regulatory compliance purposes, making the initial standard unattractive to buyers.

A common provision allows the buyer to change the standard if it pays for re-accreditation to the new standard as well as any “downside” for the seller(s). The downside would include things like the cost of unsold emission reductions if the new standard required that more emission reductions be held aside as a buffer.

Box 8. Sample Validation and Verification Clause

Article 6. *Validation and Verification.*

6.1 *Standards.* The parties shall ensure that the Emission Reductions are validated and verified according to the Voluntary Carbon Standard (the “**Carbon Standard**”), and that the climate, community, and biodiversity benefits of the Project are validated and verified according to the Climate, Community, and Biodiversity Standards (the “**Co-Benefits Standard**”).

6.2 *Responsible Party.* The Seller Representative shall submit all required materials and documentation for VER validation, verification, registration, and issuance (collectively, “**Accreditation**”) under the Carbon Standard and the Co-Benefits Standard and shall act as the primary contact for Accreditation.

6.3 *Standard Selection.* The Buyer shall select the individuals or entities to conduct accreditation as required by the Carbon Standard and the Co-Benefits Standard. The Buyer may change the designated Carbon Standard up to two times for any reason, but the Buyer shall pay for re-Accreditation and any additional costs or lost revenue that the Seller Representative experiences because of re-Accreditation.

6.4 *Costs.* The Buyer shall pay all costs of Accreditation.

6.5 *Standard Availability.* If the Carbon Standard becomes unavailable through no fault of the parties, the parties shall select a replacement Carbon Standard by mutual agreement, with any costs of re-Accreditation to be paid one half by the Seller Representative and one half by the Buyer. If the Co-Benefits Standard becomes unavailable through no fault of the parties, the parties may select a replacement Co-Benefits Standard by mutual agreement or may proceed with Accreditation under the Carbon Standard alone.

The sample agreement provides for the use of the Climate, Community, and Biodiversity (CCB) Standard in addition to the Voluntary Carbon Standard, which is a common combination and approach. Accreditation under the CCB provides a qualitative assessment of the project’s social and environmental benefits – sometimes called “co-benefits.” Accreditation of environmental and social co-benefits is not required. However, it can help to ensure that carbon benefits do not come at the expense of other social or environmental goals, can increase the price of VERs, and can be used to generate more interest in the project.

The project plan that is attached to the agreement should contain a thorough assessment of the project area, which can serve as a baseline for monitoring and verifying results, though the chosen accreditation standard will likely establish its own baseline during the validation process.

Default and Remedies

There are innumerable ways in which a forest carbon project can go wrong, destroying all or part of the value of the deal for one or more parties. When this happens, parties often look to the purchase agreement to see if another party can be held responsible or if any of their losses are recoverable. This reality underscores the importance of contractual terms defining what is, and is not, a violation of contractual obligations, and when and what remedies are available.

The following sections discuss *force majeure* and a failure to make or accept a VER delivery, neither of which is generally considered to be a violation of contractual terms, as well as the definition of default and remedies clauses.

Force Majeure

First, circumstances that interfere with contractual performance but are wholly outside of the control of the parties (so-called “force

majeure”), such as natural disasters, wars, and the like, do not generally cause either party to be in breach of the agreement. Force majeure may permit one or more of the parties to terminate the agreement, in which case the agreement may or may not call for settling up of accounts between the parties.

Box 9. Sample Force Majeure Clause

Article 7. *Force Majeure*

7.1 *Non-Liability*. Neither party will be liable for any loss or damage suffered or incurred by the other party due to its failure to perform due to war, riot, insurrection, civil unrest, martial law, national general strike, wildfire, insect infestation, outbreak of plant disease, flood, earthquake, storm, accumulation of snow and ice, epidemic, quarantine, radiation or radioactive contamination, or any other circumstance beyond the control of parties (including a change of law) (each a “**Force Majeure Event**”) provided that the non-performing party shows that:

(a) Reasonable steps were taken under the circumstances to minimize delay or damages caused by foreseeable events;

(b) All non-excused obligations were substantially fulfilled;

(c) The other party was timely notified of the actual occurrence of the Force Majeure Event; and

(d) If the non-performing party is the Seller Representative and the Force Majeure Event is a wildfire, insect infestation, or outbreak of plant disease, that the Participating Landholders substantially performed the risk mitigation measures referred to in clause 1.4.

A change of law, which the sample agreement treats as a force majeure event, is generally addressed separately (and much more extensively). The complexity is meant to account for the wide range of things that can go

wrong from a regulatory perspective. For example:

- The host government could impose an obligation on participating landholders to reduce their net carbon emissions, destroying the “additionality” of any carbon reductions.
- The government in the buyer’s jurisdiction could implement a mandatory greenhouse gas emission reduction law that covers the buyer but does not recognize offsets, or does not recognize the project’s emission reductions.
- The host government could withdraw the participating landholders’ rights to sell, or could appropriate the land or the carbon.
- New tax laws in either the seller’s or the buyer’s jurisdiction could destroy the value of the transaction.

Each of these eventualities could have drastic consequences for a forest carbon buyer and/or seller. As a result, “change of law” clauses are often highly complex and heavily negotiated, based on specific circumstances and risks in the seller’s and buyer’s countries and the relative bargaining power of the parties. The sample agreement classifies a change in law as a force majeure event not to minimize these issues, but to avoid delving into a complex set of contract provisions that are extremely context-dependent.

Failure to Make or Accept Delivery

Under a long-term forest carbon contract, delivery of VER is likely to happen in installments, as provided in the sample agreement. Parties may want to include specific language on what happens if a seller fails to make, or a buyer fails to accept, a single delivery. Generally, this type of failure does not cause a breach of the whole agreement, but simply triggers damages for the undelivered installment.

If no, or fewer than expected, VERs are issued, then this would not be considered to cause a failure to make delivery under the sample agreement. Because the contract calls for delivery of all VERs generated and issued during a given period of time, a failure to make or accept delivery can only occur if VERs are generated and issued, yet delivery fails to occur.

Damages (in monetary fees) for an undelivered installment are meant to remove any incentive for either party to violate its delivery obligations because it can get a better deal on the spot market or elsewhere. These damages are not usually designed as a punishment, but are meant to make the other party “whole” in terms of putting that party in the position that it would have been in, had VERs been delivered or accepted as promised.

If a seller fails to deliver VERs, it would typically have to pay the buyer’s replacement cost, or the positive cost, if any, of replacement VER above the agreed contract price. In other words, the buyer will pay the contract price *and no more* for the credits that it expected to receive, even if the price of replacement VER is higher. If the price of replacement VER is lower than the contract price, then the seller will not owe damages.

Conversely, if a buyer fails to accept delivery, it would have to pay the seller’s replacement cost – the negative difference, if any, between the contract price and the price that the seller is able to get from a replacement buyer. In other words, the seller will get *no less* than the contract price for its credits. If the price that a replacement buyer is willing to pay is higher than the contract price, then the buyer will not owe damages.

Damages also generally include interest that accrues from the delivery date, as well as costs and fees owed by the performing party due to the non-performance.

Box 10. Sample Clauses for Delivery Failure

Article 8. *Failure to Make or Accept Delivery.*

A failure to make or accept delivery of VERs is not an Event of Default, as that term is defined in clause 9.1, and does not cause or permit termination of this agreement. A party that owes damages under clause 8.1 or 8.2 shall pay those damages no later than 10 Banking Days after the date on which that party receives notice of delivery failure.

8.1 *Failure to Make Delivery.* If the Seller Representative fails to make delivery of VERs as provided in clause , the Seller Representative shall pay the Buyer the positive difference, if any (the “**Buyer’s Replacement Cost**”), between (1) the price the Buyer, acting in a commercially reasonable manner, does or would pay in an arm's length transaction for an equivalent quantity of equivalent VERs to replace the VERs that were not delivered (the “**Default Quantity**”), and (2) the Contract Price multiplied by the Default Quantity, plus

(a) interest on the Buyer’s Replacement Cost at an annual rate equal to LIBOR plus 3% compounded monthly from and including the Delivery Date to but excluding the date payment is made, plus

(b) the amount of reasonable costs and expenses that the Buyer incurs in respect of the Default Quantity (including, without limitation, broker fees, commissions and legal fees).

8.2 *Failure to Accept Delivery.* If the Buyer fails to accept delivery of VERs as provided in clause , the Buyer shall pay the Seller Representative for the positive difference, if any (the “**Seller Representative’s Replacement Cost**”), between (1) the Contract Price multiplied by the Default Quantity and (2) the price the Seller Representative, acting in a commercially reasonable manner, does or would receive in an arm's length transaction for the Default Quantity, plus

(a) interest on the Seller Representative’s Replacement Cost at an annual rate equal to LIBOR plus 3% compounded monthly from and including the Delivery Date to but excluding the date payment is made, plus

(b) the amount of reasonable costs and expenses that the Seller Representative incurs in respect of the Default Quantity (including, without limitation, broker fees, commissions and legal fees, but not including the amount, if any, payable in respect of excess emissions penalties).

Event of Default

Forest carbon agreements must define an “event of default.” An event of default is a breach of, as opposed to a minor or *de minimis* deviation from, contractual obligations.

Box 11. Sample Default Clause

Article 9. *Event of Default.*

9.1 *Definition.* Each of the following is an “**Event of Default**” on the part of the Buyer or the Seller Representative:

(a) Dissolution, liquidation, insolvency, or bankruptcy;

(b) Material breach of a representation or any material term of this agreement;

(c) Knowingly or negligently providing information that is materially false or misleading to the other party;

(d) A failure to deliver payment when due.

9.2 Successive failures to deliver VERs as provided in clause 2.1 for three consecutive years is an additional Event of Default on the part of the Seller Representative.

9.3 Successive failures to accept delivery of VERs as provided in clause 2.1 for three consecutive years is an additional Event of Default on the part of the Buyer.

In contrast with the simple language in the sample agreement at 9.1(a), bankruptcy default provisions are often very long, complicated, and heavily negotiated. The complexity is to prevent entities that are reorganizing, merging, or being purchased from evading contractual obligations. Detailed bankruptcy provisions are likely to be required in the forest carbon context as the market matures and expands and small, independent carbon brokers (forest carbon buyers, often) may be acquired by larger commercial entities.

In terms of simple failure to perform under the agreement, any failure by the buyer to pay is generally treated as a default (though a short grace period may be provided), where a failure by the seller to deliver one or more installments does not generally rise to that level. Compare clause 8.1 to clause 9.1(d) in the sample agreement.

Remedies

It is important to define an event of default precisely, because if an event of default occurs, contractual remedies become available to the non-defaulting party. However, a “cure period” may be provided for the defaulting party to fix the problem without triggering the remedies provision.

Contractual remedies may be the only recourse available, or the non-breaching party may also be able to seek recovery in a court of law. The agreement may also provide for different

remedies, depending on the severity or willfulness of the breach, or other circumstances.

If in-kind payments are used in the form of equipment, then the parties might consider repossession as a remedy for default by the sellers’ representative. However, care should be taken before imposing monetary damages or repossession on small-scale and community-based sellers, for whom they could be devastating.

Box 12. Sample Remedies Clause

Article 10. *Remedies*.

10.1 *Default Notice*. If either party becomes aware that an Event of Default has occurred on the part of the other party, it shall promptly notify the other party in writing of the Event of Default (the “**Default Notice**”).

10.2 *Cure Period*. Unless an Event of Default is due to material breach of a representation, is intentional, or is the result of gross negligence, the defaulting party may cure the Event of Default within five Banking Days of delivery of the Default Notice, thereby precluding the availability of remedies under this clause.

10.3 *Remedies*. In the case of an Event of Default by the Seller Representative:

(a) The Buyer is limited to the remedies expressly provided in this agreement.

(b) The Buyer may terminate this agreement and, if the Event of Default is intentional or due to gross negligence on the part of the Seller Representative, the Seller Representative shall return advance payments, if any were made, and shall pay U.S. \$ _____ in liquidated damages not later than 10 Banking Days after the Seller Representative receives the Default Notice.

10.4 In the case of an Event of Default by the Buyer:

(a) The Seller Representative is limited to the remedies expressly provided in this agreement.

(b) The Seller Representative may terminate this agreement and, if the Event of Default or due to gross negligence on the part of the Buyer, the Buyer shall pay U.S. \$ _____ in liquidated damages not later than 10 Banking Days after the Buyer receives the Default Notice.

Dispute Settlement

In order to facilitate conflict resolution, the parties should define procedures for settling disputes under the purchase agreement, such as how a certain term or phrase should be interpreted or what the rights and responsibilities of parties are under specific circumstances.

Most disputes are likely to be resolved informally, which the sample agreement formalizes in clause 11.1 (Box 15). Informal discussion is the least cost alternative for dispute resolution.

Box 13. Sample Dispute Resolution Clause

Article 11. *Dispute Resolution.*

11.1 *Informal Discussion.* In the event a dispute arises under, out of, or relating to the interpretation, application, or performance of this agreement, the parties shall first attempt to resolve the dispute by discussion and negotiation.

11.2 *Choice of Law.* This agreement is governed by, and is to be construed in accordance with, the laws of the United States and the State of New York, as applicable.

Though the sample agreement does not do so, the agreement may allow or require mediation and/or arbitration if the parties fail to resolve the dispute by informal discussion. Both mediation

and arbitration are forms of “alternative dispute resolution,” (ADR) because they provide an alternative to resolving disputes in court. In mediation, the parties submit their dispute to a third party that tries to help them find a compromise solution. In arbitration, one or more persons – the arbitrators or arbitral tribunal – will evaluate the dispute and come to a decision, while remaining removed from the discussion and settlement process between the parties.

In mediation, the parties are bound to seek a mutually-agreeable solution, although they are not generally bound to an outcome. In arbitration, the parties agree to present the matter to an arbitrator instead of going to court. The parties may or may not be bound to comply with the outcome of arbitration, but agreements often provide for non-binding mediation and binding arbitration.

Binding arbitration under agreed protocols can provide certainty in neutral forum for international parties. The Permanent Court of Arbitration is often used in international purchase agreements, although other forms of arbitration exist. Arbitration is non-public and can be made confidential, which many commercial entities prefer.

Arbitration procedures can be varied to suit the needs of the parties. For example:

- Using “bracketed arbitration,” the parties agree in advance to the range of values that may be awarded, e.g. where liability is not disputed.
- In “baseball arbitration,” the arbitrator must rule for the party that has the most reasonable position and may not split the difference or decide on a compromise position.

Other variations exist. In general, the outcome of binding arbitration may not be challenged in

a court of law, but is binding on the parties and the court.

Miscellaneous

Toward the end of a forest carbon emission reductions purchase agreement come “boilerplate” clauses – clauses that vary little between similar agreements – and clauses addressing miscellaneous matters.

Box 14. Sample Miscellaneous Clauses

Article 12. *Miscellaneous*

12.1 *Confidential Information.* The parties shall treat the terms of this agreement and all information specifically identified as confidential under or in connection with the agreement (collectively, “**Confidential Information**”) as confidential and may neither disclose Confidential Information nor use it other than for *bona fide* purposes connected with this agreement without the prior written consent of the other party, except that consent is not required for disclosure:

(a) To directors or employees of a party and persons professionally engaged by a party, any financial institution that is offering or may offer finance related to the Project, any intended assignee of the rights and interests of a party under this agreement, if the person to whom Confidential Information is disclosed is required by the disclosing party to treat the Confidential Information as confidential in favor of the other party on terms substantially the same as those set out in this clause 12.1; or

(b) To the extent legally required by applicable law, or by a governmental entity, agency or regulatory authority having jurisdiction over the disclosing party; or

(c) To the extent that the Confidential Information is in or lawfully comes into the public domain other than by breach of this clause 12.1.

12.2 *Assignment.* Neither party shall assign or transfer its rights or obligations under this agreement to a third party without the prior written consent of the other party to this agreement, such consent not to be unreasonably withheld.

Assignment clauses, like bankruptcy clauses, tend to vary widely. In the forest carbon context, there are many start-up companies that expect to be acquired by other companies. These buyers will want a permissive assignment clause so that they are able to transfer their contractual rights and obligations at acquisition.

Box 15. Sample Miscellaneous Clauses

12.3 *Waiver.* Failure by either party to enforce any provision of this agreement is not a waiver of that provision or of any future breach of that provision, and in no way affects that party’s right to require performance under this agreement thereafter.

12.4 *United Nations Convention on Contracts for the International Sale of Goods and Contracts (Rights of Third Parties) Act.* The United Nations Convention on Contracts for the International Sale of Goods and Contracts (Rights of Third Parties) Act does not apply to this agreement.

The United Nations Convention on Contracts for the International Sale of Goods and Contracts (CISG) is a treaty containing uniform international sales law that has been ratified by most major trading countries in the world (except, as of November 2010, Brazil, Africa, India, and the United Kingdom). It is equivalent to the Uniform Commercial Code Article 2 (Sales) in the United States. Parties to a contract may opt out of application of the CISG, but they must do so explicitly.

Box 16. Sample Miscellaneous Clauses Continued

12.5 *Entire Agreement.* This agreement is the entire agreement between the parties concerning the purchase and sale of VER and supersedes any prior agreements, understandings, or representations with respect to the purchase and sale of VERs. Any modification of this agreement must be in writing and signed by each party.

12.6 *Severability.* If any provision of this agreement is held to be invalid, illegal, unenforceable, or in conflict with the law of any jurisdiction, such holding will not affect the validity, legality, and enforceability of the remaining provisions.

12.7 *Notices.* Any notice that is required or permitted by this agreement must be in writing, in English, and must be delivered personally, by courier, postal mail, email (with return receipt confirmation), or facsimile to the address provided below:

If to the Seller Representative:

Address:

Phone:

Fax:

Email:

If to the Buyer:

Address:

Phone:

Fax:

Email:

While the sample agreement provides that notice may be given by email, many agreements provide that notice is not effective until received by other means.

Interpretation & Definitions

Contract language must be used precisely, as small misunderstandings, mistakes, or inconsistencies can alter the rights and

obligations of the parties. Two important parts of an agreement are therefore those explaining how certain language is to be interpreted and outlining terms that are used in the agreement.

Interpretation

The interpretation section contains information applicable to large portions of the agreement about how terms or headings should be treated. Because timing is important for things like delivery and payment, it also generally includes information about how time and days (or calendar days, business days, or banking days, whichever is used in the agreement) should be measured.

Box 17. Sample Interpretation Clauses

Article 13. *Interpretation.*

13.1 *Capitalized Terms.* Capitalized terms not defined in the body of this agreement have the meanings assigned to them in Article 14 .

13.2 *Interpretation.*

(a) Unless specifically stated otherwise, any reference to:

(1) any party includes that party's executors, administrators, successors and permitted assigns; and

(2) the singular includes the plural and vice versa; and

(3) the words "including", "include" or "includes" when introducing an example do not limit the meaning of the words to which the example relates to that example or examples of a similar kind; and

(4) any law, statute, or international rule includes any amendment to, consolidation, re-enactment or replacement of such law, statute, or international rule.

(5) a "clause," "article," or "annex" is a reference to a clause, article, or annex of this agreement.

(6) to time is to Eastern Standard or Eastern Daylight Time, as applicable.

(b) Headings are inserted for convenience of reference only and do not affect the interpretation of this agreement.

(c) Unless otherwise specified, where anything is to be done under this agreement:

(1) by or not later than a Banking Day or any period is to run to a Banking Day, such thing may be done by, or such period is to run to, 17:00 hours on that Banking Day;

(2) from or not earlier than a Banking Day or any period is to run from a Banking Day, such thing may be done or such period is to run from 09:00 hours on that Banking Day;

(3) on a Banking Day, it is to be treated as having been done on the next following Banking Day if it is done after 17:00 hours on that Banking Day.

Definitions

Words and phrases that have specific meaning in the context of the agreement are defined and highlighted in context throughout the agreement. Defined terms are capitalized when used in order to avoid confusion about when the common meaning, as opposed to the defined meaning, is intended.

A dedicated definitions section is usually included to provide more information about defined terms, or to define technical terms that are used – but not defined – in the agreement.

The definitions section may appear first, to provide context and background information for a reader of the agreement. However, the sample agreement puts the definitions section at the end of the agreement. The ordering of clauses within an agreement is largely a matter of preference.

Box 18. Sample Definitions Clauses

Article 14. *Definitions.*

14.1 **Accreditation** means validation and verification by an established standards organization, according to a published standard, that determines whether the Project is likely to, and actually does, yield claimed benefits.

14.2 A **Banking Day** is any calendar day other than:

(a) A Saturday or Sunday;

(b) Any official banking holiday in the country and locality specified in clause 11.2 (Choice of Law).

14.3 **Buyer's Replacement Cost** has the meaning given in clause 8.1.

14.4 **Carbon Standard** means the standard selected by the parties in accordance with clause 6.1 that will be used to evaluate whether the Project is likely to, and actually does, yield claimed carbon benefits.

14.5 **Co-Benefits Standard** means the published standard selected by the parties in clause 6.1 that will be used to evaluate whether the Project is likely to, and actually does, yield claimed social and environmental benefits.

14.6 **Confidential Information** has the meaning given in clause 12.1.

14.7 **Contract Price** is the price specified for delivered VERs under this agreement.

14.8 **Default Notice** means the notice, given to the defaulting party by the non-defaulting party under clause 10.1, that a party is in default under this agreement.

14.9 A **Delivery Date** is the date each year on which Delivery is to occur during the Agreement Term, as provided in clause 2.1.

14.10 **Emission Reductions** mean the total carbon emission reductions that are attributable to Project Activities plus the total increased carbon sequestration that is attributable to Project Activities. Emission Reductions are expressed in tons of CO₂. Total carbon emission reductions and total increased carbon sequestration are calculated as provided in the Project Plan.

14.11 **Event of Default** has the meaning given in clause 9.1.

14.12 **Force Majeure Event** has the meaning given in clause 7.1.

14.13 **Participating Landholders** mean the individuals that have use rights in the Project Area and undertake Project Activities in accordance with the Project Plan.

14.14 A **Payment Due Date** is the date on which payment is due for a Transaction, as provided in clause 3.4.

14.15 The **Project** is the set of activities to reduce emissions from deforestation and degradation and enhance carbon sequestration described in the Project Plan.

14.16 **Project Activities** mean the activities outlined in the Project Plan that Participating Landholders and the Seller Representative undertake in order to enhance carbon sequestration or reduce emissions from deforestation and degradation within the Project Area.

14.17 The **Project Area** means the area defined in annex 2.

14.18 The **Project Plan** is the document describing Project Activities that is attached as annex 1.

14.19 The **Registry** means the VER transaction platform agreed between the parties.

14.20 **Seller Representative's Replacement Cost** has the meaning given in clause 8.2.

14.21 A **Statement** is an invoice, submitted pursuant to clause 3.2, covering money owed by the Buyer to the Seller Representative in connection with a Transaction.

14.22 The **Statement Amount** is the net quantity of money owed in connection with a Transaction.

14.23 A **Transaction** is a delivery and acceptance of VERs as described in clause 2.1.

14.24 **VAT** are the value-added-taxes that are assessed on either party as a result of Project Activities.

14.25 **Verified Emission Reductions or VER** mean Emission Reductions that have been validated and verified as provided in clause 6.1.

Wrapping Up: Signatures and Annexes

Signatures

To signify their understanding and mutual agreement, the parties must sign the agreement. A dedicated signatures page is generally provided for that purpose. In most circumstances, the agreement becomes effective when the last party to sign the agreement signs. This is the date that should appear in the introductory clause.

Box 19. Sample signature block.

The parties are signing this agreement on the date stated in the introductory clause.

SELLER REPRESENTATIVE ASSN

By: _____

Name

Title

INVESTOR CORP

By: _____

Name

Title

If a party is an organization or entity, its signature line should begin with “By” (shorthand for “By its duly authorized signatory”) to indicate that the signatory is not signing in his or her personal capacity.

Annexes

Important background information, templates, and information that would be unwieldy to include in the body of the agreement are often included as annexes or attachments to the agreement. In the sample agreement, the following documents are attached to the agreement:

- The project plan.

- A description of the project area.
- Payment account information and advance payment schedule.
- Land use grant showing that participating landholders have requisite rights in the project area.
- Agreement authorizing the sellers’ representative to represent sellers/participating landholders and to oversee project governance and benefit distribution.

The project plan is a very important part of the purchase agreement. It describes what activities will be undertaken and by whom, how the project will be governed, and how revenues will be disbursed to participating landholders, among other things. A sound project plan assures buyers that the project will be governed fairly and transparently, with equitable benefit-sharing, and that the project is likely to generate VERs.

A precise description of the legal boundaries of the project area, specification of the payment account, and payment schedules, are similarly included in an annex because they would be unwieldy in the body of the agreement.

In comparison, the land grant and agreement with the sellers’ representative do not properly belong in the body of the agreement in any case. Rather, they are provided as evidence to the buyer that certain legal rights and safeguards exist.

Conclusion

While they resemble typical purchase agreements in many ways, forest carbon purchase agreements are likely to have certain unique aspects. For example:

- Where the agreement describes a forward purchase of VERs, robust project design and governance will be central to the contract.
- Structuring payments may be challenging, particularly where advance payments are needed or multiple sellers are involved.
- Diverse risks must be allocated between the parties to a forward purchase agreement for forest carbon.

Forest carbon sellers – particularly those with small-scale or community-based projects – may be at a particular disadvantage. First, they may have little commercial or contracting experience, in which case particular care should be taken to make sure that all parties understand their contractual rights and obligations before signing. Second, they may have little or no ability to absorb major costs or penalties during the course of the project. Where this is true, creative drafting must be used to ensure that default and remedies clauses serve to effectively deter breach without imposing excessive penalties on parties that cannot bear them.

This document provides only one simplified potential approach to these and other issues. Consulting other available purchase agreements, particularly ones that were written for transacting in carbon credits, can give a sense of alternate approaches and contractual language, as well as a sense of the range of options that may be negotiated.

Additional Resources

For more information, see:

- The Katoomba Group Online PES Contract Toolkit: www.katoombagroup.org/legal, for links to template ERPA and other resources about legal and contractual issues around forest carbon and other payments for ecosystem services.
- CERSPA, at www.cerspa.org, for a well-drafted template ERPA and guidance document, available in a number of different languages.
- The International Emissions Trading Association's Emissions Trading Master Agreement for the EU Scheme, at www.ietagroup.org/ietagroup/pages/getfile.php?docID=194. This document is a template agreement that was developed to facilitate trading in emission reductions between regulated entities in the EU ETS.

The template agreements from CERSPA and IETA do not specifically concern forest carbon, but nevertheless contain useful guidance for carbon contracting more generally.

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