

**NEGOTIATING
ANTHROPOGENIC CO₂-EOR
OFFTAKE CONTRACTS IN A
CHANGING POLICY
ENVIRONMENT**

MIDLAND CONTRACTING SEMINAR

DECEMBER 3, 2012

Caution Before You Begin

2

- (1) Everything you memorialize in contract language may, in theory, influence whether: (1) CO₂ capture is deemed a Best Available Control Technology for the CO₂ source (economics); (2) EPA or a State regulator can later determine that the EOR owner/operator must transition from Class II to Class VI (core contract provisions); and (3) the project is eligible to obtain “carbon credits” (additionality)
- (2) Don’t assume documents/information will necessarily remain confidential. See, e.g., (1) PSD/Title V; (2) Subparts PP/RR/UU; (3) Section 45Q, etc.

So You Want “Carbon Credits,” too?: Teachings from the Clean Development Mechanism

3

If the projects start date **before 2 August 2008**, DOE's must assess the project participant's prior consideration of the CDM using **document reviews**:

For an existing project activity with a start date before 2 August 2008, for which the start date is prior to the date of publication of the PDD for global stakeholder consultation, the DOE shall assess the project participant's prior consideration of the CDM through **document reviews** and shall satisfy following requirements:

- a. Evidence that must indicate that awareness of the CDM prior to the project activity start date, and that the benefits of the CDM were a **decisive factor in the decision to proceed** with the project.
- b. Evidence to support this would include, inter alia, **minutes and/or notes related to the consideration of the decision** by the Board of Directors, or equivalent, of the project participant, to undertake the project as a proposed CDM project activity.
- c. Reliable evidence from project participants that must indicate that continuing and real actions were taken to secure CDM status for the project in parallel with its implementation. Evidence to support this should include one or more of the following: **contracts with consultants for CDM/PDD/methodology services, draft versions of PDDs and underlying documents such as letters of authorization, and if available, letters of intent. Emission Reduction Purchase Agreements or other documentation related to the sale of the potential CERs** (including correspondence with multilateral financial institutions or carbon funds), evidence of agreements or negotiations with a DOE for validation services, submission of a new methodology to the CDM Executive Board, publication in newspaper, interviews with DNA, earlier correspondence on the project with the DNA or the UNFCCC secretariat (EB 62, Annex 13, paragraph 6).

Source: CDM Toolkit, “Additionality” (sic) (emphasis added)

Who Is Your Client?

4

- ▣ CO₂ Source
- ▣ Pipeline
- ▣ CO₂-EOR Owner/Operator

Nature of the CO₂ Source

5

- ▣ Natural or anthropogenic?
- ▣ If anthropogenic –
 - *Is the source subject to, or likely to become subject to, GHG permitting requirements or standards?*
 - *May CO₂ from such sources be resold by the EOR owner/operator?*
 - *Does the source qualify for the Indiana Gasification, LLC rule?*
 - *Are you engaged in “legal” sequestration?*
 - *Even if the source is not subject to, or not likely to become subject to, GHG permitting requirements or standards, does the source (or the project) intend to generate –*
 - *Offset credits, or*
 - *Voluntary credits?*
- ▣ Existing or Not-Yet-Developed?
 - Dramatically different risk profiles – generous use of conditions precedent might be appropriate for the latter

Nature of the CO₂ Source

6

- ▣ Location
 - Overseas
 - Jurisdiction with climate control programs?
 - Jurisdiction eligible for the Clean Development Mechanism?
 - US
 - Does the State have it own climate program?
 - Is the State likely to obtain primacy for UIC Class VI?
 - Does the State have laws/regulations/case law on CCUS?
- ▣ Federally funded or seeking federal/state incentives?
- ▣ Proximity to EOR fields
- ▣ Proximity to existing infrastructure (pipelines, etc.)

General Document Structure for CO₂ Offtake

7

- ▣ CO₂ Offtake Contract
 - *Keep it simple and straightforward*
- ▣ Project Development Agreement
 - *May be appropriate/necessary if complicated project development considerations*
- ▣ Emissions Reduction Purchase Agreement
 - *May be appropriate to deal with “carbon credit” issues separately*

U.S. EPA: Pending Guidance on Transitioning from Class II to Class VI

8

▣ 40 CFR § 144.19

- (a) “Owners or operators that are injecting [CO₂] for the primary purpose of long-term storage into an oil and gas reservoir must ... obtain a Class VI ... permit when there is an increased risk to USDWs compared to Class II operations.”
 - Two fundamental considerations:
 - What is the meaning of “primary purpose of long-term storage”?
 - Who assesses potential increased risk, and what factors are to be considered?

U.S. EPA: Assessing Potential Increased Risk

- “The Director shall determine when there is an increased risk to USDWs compared to Class II operations and a Class VI permit is required.” (40 CFR § 144.19(b))
- “The Director must consider the following (id.):
 - “Increase in reservoir pressure within the injection zone(s);
 - “Increase in [CO₂] injection rates;
 - “Decrease in reservoir production rates;
 - “Distance between the injection zone(s) and USDWs;
 - “Suitability of the Class II area of review delineation;
 - “Quality of abandoned well plugs within the area of review;
 - “The ... plan for recovery of [CO₂] at the cessation of injection;
 - “The source and properties of injected [CO₂];
 - “Any additional site-specific factors as determined by the Director.”

U.S. EPA: Commercial Considerations of 40 CFR § 144.19

10

□ Uncertainties

- Open-ended inquiry
 - “Any additional site-specific factors”
- When is the determination made? Can it be made retroactively?
 - “Decrease in reservoir production rates”
- Commercial differences between upstream source and EOR operator
 - “Increase in [CO₂] injection rates”
- If the upstream source is engaged in “sequestration,” then ...
 - “[S]ource and properties of injected [CO₂]”
- What happens when injections cease?
 - “[Plan for recovery of [CO₂] at the cessation of injection”
- Proceed with caution when negotiating deal documents, including CO₂ offtake agreement
 - Lessons learned from early years of the Clean Development Mechanism

U.S. Treasury: 45Q CCS Tax Credit

11

- IRS published interim guidance in 2009 (Notice 2009-83, Nov. 2, 2009)
- Meaning of “secure geological storage”
- “In the event that a taxpayer disposes of the qualified CO₂ contractually, the taxpayer must ensure that the contracting party complies with the requirements of this section of the notice at all times, and the taxpayer must be able to provide documentation of such compliance” (IRS Notice 2009-83, § 5.01 (Nov. 2, 2009))
- IRS re-examining what is required

THANK YOU

FOR MORE INFORMATION:

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