KEY CONSIDERATIONS IN POWER PURCHASE AGREEMENT (PPA) RISK ALLOCATION AND COMMON CLAUSES WHICH FORM PART OF A PPA

AFRICA UTILITY WEEK CONFERENCE

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OUTLINE

• Background

• NBET – Introduction

• NBET – Key Roles

• Power Project Risks

• Spectrum of Risks Covered by the PPA

• Duration of the Risks

• Cardinal Principle of Risk Allocation

• Classification of Risks

• Pre-COD Risks

• Post-COD Risks

• Force Majeure Risk

• Risk Mitigation Strategies & Instruments

• Common Clauses Which Form Part of a PPA

• Effective use of Standardized PPA Templates for Power Purchase Negotiations

• Standard PPA Template Customisation: Project Specifics

• Advantages Of Standardization

• Conclusion
Many countries are increasingly relying on the private sector to plug the investment gap in critical infrastructure such as power.

**Objectives of the Parties:**
- **Government** - power infrastructural development for domestic and commercial uses
- **Independent Power Producers (IPPs)** – Investment in power generation and reasonable return on investment

- Power generation is very capital and risk intensive
- Optimum risk allocation ensures a mutually rewarding long term business relationship
- The PPA documents the terms of the business relationship and expectations of the parties
THE NIGERIAN BULK ELECTRICITY TRADING PLC (NBET) - INTRODUCTION

- Established pursuant to the Electric Power Sector Reform Act (EPSRA) 2005 (a.k.a. the ‘Bulk Trader’) and wholly owned by the Federal Government of Nigeria; Incorporated as a Public Limited Company (PLC) in July 2010; 9-member Board inaugurated in August 2011.

- Policy framework contained in FGN’s Road Map for Power Sector Reform adopted in August 2010

- Trading licensee, licensed and regulated by the Nigerian Electricity Regulatory Commission (NERC), to undertake bulk purchase and resale of electricity in the Transitional Electricity Market

- **Vision** – A Nigeria where power is taken for granted. How will this be attained?
NBET – KEY ROLES

• Credit worthy off taker to incentivise private investments in power generation in Nigeria

• Broker between power producers and distributors/eligible customers. Power purchased through PPAs to be resold to distribution companies through Vesting Contracts

• Will takeover and manage existing PPAs and negotiate and execute new PPAs.

• NBET’s PPAs to be backed by World Bank PRG (payment & regulatory risks) and Multilateral Investment Guarantee Agency (MIGA) political insurance

• Executed 7 PPAs and 11 Vesting Contracts on February 21, 2013, as part of the ongoing power sector privatization programme; First project-financed IPP PPA executed on April 22, 2013 (Azura-Edo IPP Project)

• Currently engaging various IPPs at different stages of project development. Negotiations focus on achieving optimum risk allocation between NBET and IPPs
Transitional Market Structure

GenCo1
GenCo2
GenCo3
Existing IPPs
Existing IPPs
Existing IPPs
New IPPs
GenCo4
GenCo5
GenCo6

POWER PURCHASE AGREEMENTS

NBET Plc

PPAs

Eligible Customers

DisCo 1
DisCo 2
DisCo 3
DisCo 4
DisCo 5
DisCo 6
DisCo 7
DisCo 8
DisCo 9
DisCo 10
DisCo 11

Additional Capacity

Existing IPPs

Nigerian Bulk Electricity Trading Plc
POWER PROJECT RISKS

• Principally, events or situations that could:

  ✓ Affect the completion or continuous operation of the power plant.

  ✓ Trigger breach of contract by the IPP or the Offtaker.

  ✓ Lead to early termination of the PPA.
SPECTRUM OF RISKS COVERED
BY THE PPA

• There are key risks along the electricity value chain, and the chain is as strong as the weakest link -

  ✓ Fuel supply and fuel transportation for the term of the PPA

  ✓ Plant construction, completion and performance

  ✓ Credit-worthy Offtaker of Power (Take or Pay)

  ✓ Timely payment for power

  ✓ Transmission

  ✓ Distribution
KEY CONTRACTING RISKS

Gas Supply Risks
- Gas E&P
- Gas gathering / processing
- Gas availability
- Gas quality

Gas Pipeline Risks
- Gas transportation
- Gas quality / pressure
- Gas availability
- Line pack

Gas Supply

IPP

SINGLE BUYER

TRANSCO

DISCO

Take-or-Pay Obligation at Receipt (Gas Supplier)/Delivery (Gas Transporter) point of pipeline

Payment & Credit Risk
- Non-payment by DISCOs
- Non-performance by GENCO

Transmission Risk
- Operation and maintenance of the transmission line
- Non-payment by DISCOs of transmission charges

Generation Risks
- Construction
- Operation & Maintenance
- Technology
- Financing / interest Rate
- Labor availability and disputes
- Equipment and spare parts
- Non-payment for gas transportation failures

Distribution Risk
- O&M of DISCO network
- Collection risk
- Technical, commercial and non-technical losses
- Non-payment by TRANSCO for transmission failures

• Single Buyer payment risk

World Bank

FEU – Financial Solutions
DURATION OF THE RISKS

- IPP Project risks span from the initial development of the project till the conclusion of the term of the PPA

- Key Stages: - pre-COD and Post-COD

- Key Dates/Project Milestones:
  - PPA Execution Date
  - Closing Date
  - Financial Close
  - Commercial Operations Date
  - End of Term
CARDINAL PRINCIPLE OF RISK ALLOCATION

• Allocate risk to a party best able to manage the risk. Why? Optimum risk allocation:

  ✓ Makes project risks manageable

  ✓ Makes the PPA bankable [Ability to raise long term non-recourse debt, to be repaid from tariff charged by the project company]

  ✓ Lowers project costs
CLASSIFICATION OF RISKS

• Risks within Seller’s control

• Risks within Buyer’s control

• Risks not within the full control of either party (Force Majeure - NFM, LPFM or FPFM)

• The Seller’s risks are greatest before COD. Risks become more evenly balanced post COD
PRE-COD RISKS

• Project Development Risks: Includes all risks and expenses up to the time the plant attains Commercial Operations Date including:
  
  • Due Diligence/legal compliance
  
  • Risks and Expenses associated with:
    ✓ Site Acquisition
    ✓ Obtaining licences and permits
    ✓ Conducting Environmental Impact Assessment
    ✓ Utilising legal, financial and other professional services
    ✓ Plant construction including civil works and turbine installation, until the whole plant is fully completed and functional, with adequate fuel and transmission connections
  
  • Penalty payments for failure to meet PPA Closing Date (Development Security) or delayed COD (Performance Guarantee)
  
  • Risk of plant rejection for not meeting PPA specifications
POST-COD RISKS

- Legal/Regulatory Changes
- Fuel Supply and Transportation
- Plant Operation, Maintenance and Continuous Performance
- Power Offtake and Payment for the Power
- Transmission Failure
- Distribution Risk
FORCE MAJEURE RISK

• An event that is:

• Not within a party’s reasonable control or due the party’s fault

• Not reasonably foreseeable, preventable, avoidable, or surmountable

• Has material adverse effect on the project or performance of contractual obligations thereunder

• Natural Force Majeure
• Local Political Force Majeure
• Foreign Political Force Majeure
RISK MITIGATION STRATEGIES & INSTRUMENTS

• Negotiation of project agreements with fair risk allocation (PPA, GSA, GTA, O&M, LTSA, Transmission Agreements etc.)

• Effective project management and utilization of reputable and experienced contractors and consultants

• Insurance Coverage (Plant Operations)
RISK MITIGATION STRATEGIES & INSTRUMENTS

• Adequate Capitalization of the Power Offtaker

• Cost Reflective Tariff (e.g. MYTO) and proper denomination of tariff

• Fair and transparent regulation

• PPA Change in Law protection

• Comfort Letters and Sovereign Guarantees
  ✓ Put & Call Option Agreement

• World Bank Partial Risk Guarantee for PPA Payments

• Escrowing of Revenues from Distribution Companies for PPA Payments

• MIGA Political Insurance for PPA Termination
PRG Revolving Standby L/C Facility and MIGA Termination Guarantees in Support of IPPs

- **FGN (Ministry of Finance)**
- **IDA**
- **Bulk Trader**
- **IPP**
- **L/C (Commercial) Bank**

**Contractual Agreements with no regular Payment flows**

**Contractual Agreements & regular Project Payment flows**

**Payment flows in the event of a Breach of the Power Purchase Agreement**
COMMON CLAUSES WHICH FORM PART OF A PPA

• Definitions and Dates
  ✓ Insolvency, Available Capacity, Applicable Law, Change in Law/Tax, Expropriation etc.
  ✓ Closing Date, Interconnection Date, Gas Supply Start Date, COD etc.
• Term of the PPA

• Take or Pay Provision

• Tariff and Payment for Power
  ✓ Capacity Payment, Energy Payment, and other applicable tariff payments e.g. fuel payments, start up payments, transmission line payments, licences and permits payment amortization etc.

• Conditions Precedent
  ✓ Initial authorisations, project agreements, financial close, legal opinions, board approvals etc.

• Covenants, Representations and Warranties
  ✓ Good standing and legal compliance, Reasonable and Prudent Operator etc.
COMMON CLAUSES WHICH FORM PART OF A PPA

• Plant Construction, Completion and Commissioning
  ✓ Reporting procedures, Commissioning procedures and tests, delays etc.

• Plant Operation and Maintenance
  ✓ Availability Events, Outages, Plant Maintenance, Capacity Tests etc.

• Delivery of Power, Scheduling, Dispatch, Metering and Billing, Passing of Title & Risk

• Insurance and Taxes
COMMON CLAUSES WHICH FORM PART OF A PPA

- Liability and Indemnification
- Transfer/Assignment of the PPA and Rights and Obligations of the Parties
- Default and Early Termination
  - Breach of obligations, incorrect representations, insolvency, payment defaults, failure to maintain authorisations, expropriation, fuel constraint, LPFM
- Force Majeure (in PPA and other agreements relevant to plant operations)
- Natural (NFM) - fire, earthquake, flood,
  - Political (LPFM) – war, terrorism, national industrial action, change in law, lapse of authorisation. Also note FPFM
- Remedies for Beach of Contract
  - Cure periods, penalties and termination payments
- Choice of Law and Dispute Resolution
EFFECTIVE USE OF STANDARDIZED PPA TEMPLATES FOR POWER PURCHASE NEGOTIATIONS

• A standardized PPA Template could be an effective tool for PPA negotiations

• Each IPP has its own unique features that will form the basis for negotiations resulting in the customisation of the standard form PPA for specific projects

• Project specific amendments are detailed in a PPA schedule, and will override the generic provisions in the main body in the event of inconsistency.
STANDARD PPA TEMPLATE CUSTOMISATION: PROJECT SPECIFIC

- Type of IPP - 100% equity, project financed (Debt/Equity Ratio)
- Type of Fuel Source – gas, hydro, coal, solar, wind etc.
- Type of plant ownership structure – government, private, public-private JV
- Plant versus Unit by Unit Commissioning
- Project securitization arrangements
- Tariff
- Contract capacity
- Available Capacity
- Degradation/Degradation Factor
- Term of the PPA
- Reference Site Conditions
- Dates (Closing Date, Financial Close, Interconnection Date, COD etc.)
- Interest Rates and Penalty Payments
- Agreed amendments to the PPA including modifications to contractual risk allocation, conditions precedent, default scenarios, dispute settlement etc.
ADVANTAGES OF STANDARDIZATION

- Reasonably bankable document due to fair risk allocation

- Use of standard definitions and terms that are uniformly understood by all stakeholders

- Narrows the scope of negotiations and hastens timely conclusion of the PPA – given the fair risk allocation, negotiations focus largely on project specifics.

- Facilitates negotiations with several IPPs

- Promotes further development of the electricity market as prospective IPPs have clarity on the terms of the business relationship expected with the offtaker
CONCLUSION

• Fair allocation of project risks, cost-reflective tariffs, proper drafting of key clauses in the PPA and creative use of standardized PPAs, can all contribute to the:

✔ Promotion of qualitative private investments in the power sector in Africa,

✔ The development of bankable power projects, and

✔ Creation of a robust infrastructural base for rapid economic development.
THANK YOU FOR LISTENING!