Template Contract for Financing Renewable Energy Projects

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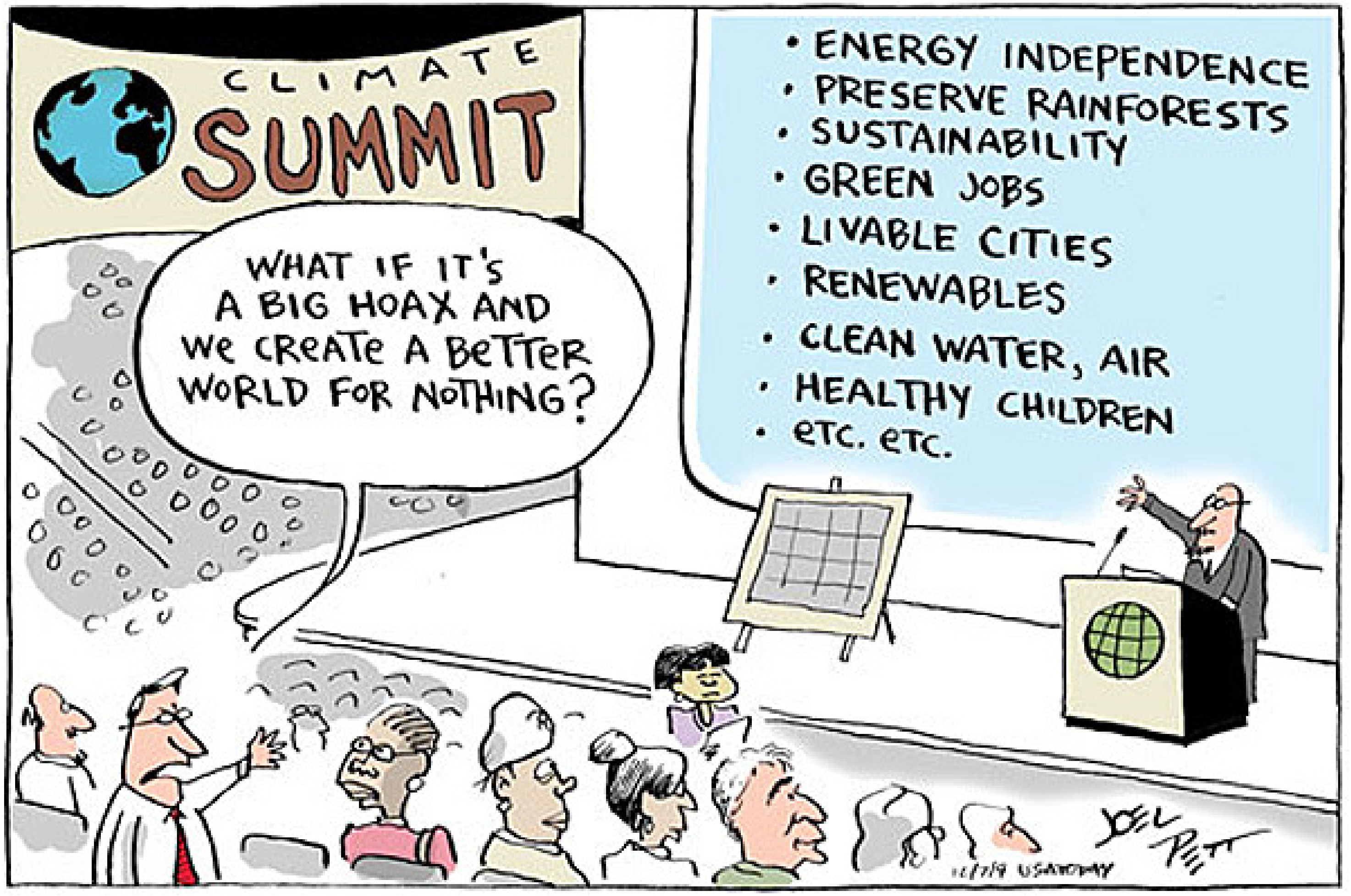

"Bankability" of the power purchase agreement (PPA) is a **critical** perquisite for financing

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- A "bankable" PPA is essential for financing renewable energy (RE) projects
  - The decision to finance an RE project hinges on the PPA (and sometimes a single provision)
  - A bankable PPA can bring down the cost of financing (improving affordability)
- Bankability does not mean eliminating the risk for the lender. Bankability involves:
  - The fair allocation of risks among key parties (power producer, offtaker, policy makers)
  - Making key elements predictable (revenues, responsibilities in different situations)
  - Providing the mechanisms and procedures for addressing risks (step-in rights, default, force majeure)
- Many provisions affect the bankability of a PPA – we cover a selection of issues that have emerged in PPAs reviewed in the last 12 months

Timing for different activities needs to reflect the different stages of the project

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- Period before commercial operation. Time between award of PPA and commercial operation (e.g. using concept of “preliminary producer”)
  - Time for construction, contracting with suppliers, raising finance, etc.
- Period for which support is offered needs to reflect a realistic payback period
  - The contract needs to be for the full duration of the support period (no periodic renewals that create uncertainty).
  - Need to recognise that loan period may be shorter than the support period (the need for a “tail”).
- Addressing events occurring during construction or operation
  - Force majeure event during construction (e.g. permit is unjustifiably withdrawn)
  - Force majeure event during operation (concept of “deemed energy output”)
  - Allow for adequate time for lenders to exercise rights (e.g. step-in, reassignment)

Lenders will focus on sources of disruptions to cashflows and credibility of offtaker

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- Some examples of important risks that can disrupt cashflows:
  - Exchange rate risk: mitigated by indexation of tariffs. A subset of exchange rate risk is convertibility risk.
  - Curtailment risk: provisions need to be included to address this risk (for example, extension of PPA or payments based on an annual operating plan).
  - Arrangements for planned and unplanned outtages (see also force majeure)
  - Connection charges and balancing costs (see also change-in-law)
- The creditworthiness of the offtaker is crucial.
  - Need to have confidence in the creditworthiness of the offtaker for the full duration of the PPA.
  - In some cases, guarantees might be needed.
  - Does not preclude sector reforms (e.g. privatisation) – but need suitable provisions (e.g. consent from lenders).

The PPA should include provisions that protect against key regulatory risks

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- Common for PPAs to include **change in law** provisions
  - Most commonly used to provide protection against retroactive changes
  - Recent examples include changes in connection charges methodology or introduction of balancing responsibility
- And provisions for **force majeure** events
  - Political force majeure or natural force majeure events.
  - Need to define circumstances under which a force majeure event occurs (e.g. territorial boundaries for events such as war, civil disorder, terrorism)
  - Need to define rights and responsibilities of producer and offtaker (for example, provide incentives for the relevant party to address force majeure event).
  - Insurance can be important for some types of force majeure events, but not all (requirements for political risk insurance or terrorism insurance can be difficult to meet)

Mechanisms to address challenges and credible dispute resolution provisions are needed

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- Direct agreements are a prerequisite for lenders
  - **Step-in rights:** provide a mechanism for lenders to address challenges faced by the producer. But adequate time provisions needed.
  - **Transferability:** for lenders, can be linked to objective criteria that are specified in the PPA (for example, technical competence, financial competence, integrity). Reassignment by offtaker typically requires lender consent.
- Critical elements for addressing regulatory risk
  - **Termination payments** (to cover all amounts outstanding to lenders)
  - Dispute resolution – recourse to **international arbitration** is a must

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Thank You

Contact

For all further enquiries, please contact:

Louis Borgo
Associate Director – Senior Banker
Power and Energy Utilities

European Bank for Reconstruction and Development
London EC2A 2JN
Tel: + 44 (0) 20 7338 6547
Email: BorgoL@ebrd.com