**This paper is for discussion and does not represent government policy or policy intent**

**Offtaker of Last Resort Advisory Group Discussion Paper 3.3:   
Contract Terms**

### Overview

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| **Summary**   * The terms for the backstop PPA will be closely based on a typical commercial contract. * The overall shape of the backstop PPA contract will be a standard fixed-term contract covering all power generated from a plant and associated benefits. * The price for the power will be paid with reference to the relevant CfD market reference price for the technology. * The generator will receive reduced revenue when power prices fall below zero, but will be protected from net negative cash-flows through constraint obligations on the offtaker. * The generator will be incentivised to provide accurate information regarding availability and outages. The contract may be terminated by the generator after 6 months (with 2 months’ notice), the offtaker has no early termination rights. * If it is below a certain credit rating, the offtaker will be required to provide credit support. The Generator does not need to provide credit support, any costs to the offtaker as a result of generator default will be levelised across all mandatory offtakers. * The pricing schedule will be considered separately, as part of the discussion on OLR pricing.   **Key questions**   * Are there specific variations that would be needed to allow for different technologies or types of project? How could the contract vary over time to reflect any changes to the market structure, while remaining bankable? * Do you agree that the backstop PPA should automatically track the CfD Market Reference Price? * Do you agree that the generator should not be protected from reduced revenue if market prices fall below zero? * Do you agree that it is possible to use curtailment provisions to protect the generator from losing money and to help the offtaker deal with imbalance risk efficiently? * Do you agree with the incentives on generators to provide accurate information on availability and outages? * Does the OLR need to deal with persistent minor breaches of obligations, spanning more than one contract? * Do you agree that any change in the strike price specifically intended to reflect changes in the costs of imbalance should lead to a change in the OLR discount? |

# Introduction

The terms in the backstop PPA are intended to mirror as closely as possible those in a typical bankable long-term commercial PPA. Using familiar structures will help lenders understand the risks they are exposed to. However, there are some areas where the backstop PPA will need to differ from a commercial contract, and some areas where the contract is shaped through negotiation between the parties and where we will need to make decisions on the final text. The structure of this paper largely follows the discussions held through the CfD Market Readiness Working Groups, which have been considering how contracting approaches will need to change to reflect the differences under the CfD. This paper outlines the overall shape of the contract and focusses on those areas where decisions will need to be made, the outcomes of discussions on these issues will feed into the drafting of specific heads of terms text.

# General Applicability

The contract terms need to be clearly specified to allow all parties to take a view of the balance of risks. This will be particularly important for financiers who are looking at the OLR to provide the backstop to their lending. There can therefore be no negotiation over the terms for specific projects. This will also help create a level playing field for competitive allocation to offtakers – offtakers will need to be clear exactly what the terms are before they consider their approach to a competitive process.

Without prejudice to the decision of OLR eligibility there may be a case that differences between types of generators (intermittent or baseload; size of facility; whether the facility is connected to the distribution or the transmission network; or biomass generators with a variable renewable fraction) may justify slight differences to the terms in the contract. However, we believe any changes necessary would be minor and would not affect the overall structure of the contract. In any event the backstop PPA would only cover capacity that is subject to a CfD.

**Question – are there specific sections of a PPA that would need to be varied to allow for different technologies or types of project?**

As the OLR will be in place for some time it will need to retain flexibility to change the terms of the contract to allow for different market structures that may emerge in years to come. To ensure bankability of the OLR, we would propose that the regulations should set out that, to the extent possible, any changes to the contract should leave the generator in the same position as prior to the change.

**Question – do you agree that there will need to be provision to update the contract to reflect different market structures? How could this be done while retaining sufficient certainty to be bankable?**

## Commencement of the contract

The commencement date shall not be more than [ x ] days from the date on which the offtaker is notified. This time allows for the Generator to provide all information that the Supplier will need to register the MPANs for the facility in accordance with the BSC.

**Question – is there anything else that needs to happen before the commencement of the operational period of the contract?**

## Term

The contract will be fixed term, but the length will depend on whether the contract is an administratively allocated PPA or a competitively allocated PPA (i.e. replacing a previous backstop PPA that has expired). If it is an administrative PPA it will run for at least six months and then the project will be entered in to the next allocation of PPAs. For example, assuming the allocation is done annually on 1 April:

* If a project accesses the OLR for the first time in January, then their first contract will run for 15 months, and (assuming they continue to need a backstop PPA) will expire in early April the following year after they have been allocated a replacement.
* If a project first accesses the OLR in August, they will enter the next allocation the following April, 8 months after the start of their initial PPA.

The second and subsequent contracts will last for 12 months.

## Sale and purchase

The contract covers all electrical output of the plant as measured by the relevant export meter, and all associated benefits. The generator will have an obligation to maximise the output and benefits for the term of the contract. This obligation will not apply in the event of negative prices – this will be discussed later.

If the PPA index matches the CfD reference price then the generator will receive a fixed price (minus the discount). However, if the CfD reference price changes while the PPA index does not, then the generator will be exposed to a new basis risk, which is likely to cause issues for lenders. In a commercial PPA there will be a decision made between the parties over what happens if the CfD reference price changes to a different index.

As the OLR is intended to be a last resort and provide a bankable backstop, it seems appropriate to cap the risks that the generator is exposed to and to remove this risk from generators that are in this position. Removing this risk from the generators will strengthen the OLR from the point of view of lenders and reduces the number of risks that they have to be comfortable with.

**Question – do you agree that the backstop PPA index should automatically track the CfD reference price?**

## 3rd party agreements

A commercial PPA may cover whether the generator can enter into 3rd party agreements, and, if so, typically states that the terms of the PPA can be renegotiated. As the terms of the backstop PPA are not bilaterally negotiable, this approach is not appropriate. However, the backstop PPA will retain a general obligation on the generator to maximise electrical output, which conflicts with the provision of ancillary services. If the generator is unable to comply with the terms of the backstop PPA they will rule out accessing the mechanism.

A generator would still be able to enter into 3rd party agreements prior to accessing the OLR, but to ensure eligibility for the OLR they would need to ensure they were able to get out of any 3rd party agreements if they needed to access a backstop PPA. We therefore do not think that a specific reference to 3rd party agreements is necessary.

**Question – do you agree that it is not necessary to specifically refer to 3rd party agreements?**

## Invoicing and payment terms

Within 10 days of the end of the month the offtaker must prepare a statement based on the metered output of the plant over the previous month. The generator shall then send an invoice to the offtaker within 10 days of receipt of the statement (or, if the amount is negative, the offtaker shall send an invoice to the generator). This invoice shall be paid within 10 days of receipt. Overall this means that the Generator will be paid within 30 days of the end of each month.

**Question – do you agree that these timings are appropriate?**

## Curtailment / Participation in the BM

In the absence of a PPA, a generator under a CfD will be incentivised to self-curtail in the day-ahead and intra-day markets, as well as bid into the BM, on the following basis:

1. **Self-curtailment at day-ahead** - Under the CfD the generator’s top-up is capped at its strike price. As such, in periods of negative pricing in the day-ahead market, the generator’s all-in revenue will fall below the level of its strike price. There will therefore be a point where the cost of paying the market to generate exceeds what it would be paid if it did (i.e. its top-up less its SRMC), at which point the generator will be incentivised to curtail its output.
2. **Self-curtailment at intra-day** – Again, if prices go negative in the intra-day market, then the economically efficient outcome would be for the generator to self-curtail where the cost of paying the market to generate exceeds what it would be paid if it did (i.e. its top-up less its SRMC). At this point, the generator would be better off actually being paid to take power in the intra-day market and using that to satisfy its day-ahead contractual position instead.
3. **Bidding in the BM** – To the extent that a generator is a signatory to the BSC and had chosen to participate in the BM, it would, theoretically at least, bid the level of its top up less its SRMC of generating.

While the likelihood of: (a) negative pricing in either the day-ahead markets or intra-day markets or (b) CfD plant being in merit in the BM is (in each case) relatively low, it is important that the backstop PPA is sufficiently future-proofed as it could be in place for generators as far ahead as 2030. As such, it should be designed to ensure that it replicates the incentives above in the way that a backstop offtaker markets the power on behalf of the generator.

This could be achieved as follows:

1. **Index Pass Through** - The offtaker will be entitled to pass any negative pricing back to the generator in the DAH index to which electricity sales under the PPA are indexed.
2. **Pass Through Cap** – However, the offtaker’s ability to pass negative prices back to the generator will be capped at the level at which, if the generator was actually marketing its power itself in the market, it would chose to curtail itself at the day-ahead stage. This will be the generator’s top up less its SRMC, (which would include the fixed discount in the backstop PPA).
3. **Right of curtailment** – The offtaker would be entitled at any time to either instruct the generator to curtail or submit a bid on the generators behalf to National Grid in the BM.
4. **Curtailment compensation** –In the event that the generator is curtailed, either on instruction from the offtaker prior to gate closure or from National Grid post gate closure in the BM, the offtaker shall pay the generator compensation calculated as:
   1. the day-ahead index price for that period; *plus*
   2. the top up payment that the generator would have received if it had generated; *less*
   3. its short run marginal costs of generating (which would include the fixed discount in the backstop PPA).

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| **Questions:**   * **Are such curtailment rights likely to cause investors and lenders concerns (e.g. from a technical / O&M perspective)?** * **Is this necessary to include in the backstop PPA? Would it be possible to negotiate separately?** * **Is there a moral hazard if the offtaker provides the forecast of generation output, and also pays compensation for lost output based on the forecast? How could this be mitigated?** |

## Metering and Meter Registration

It is not expected that this section would be significantly different from a typical commercial PPA. The generator will take responsibility for installing and maintaining the export meter for the duration of the PPA. As the offtaker will be responsible for providing notifications to National Grid, it will need to register itself in respect of the metering system, and must be allowed safe access to inspect it and collect data.

## Benefit accreditation and transfer of benefits

It is not expected that this section would be significantly different from a typical commercial PPA. The principle should be that the generator should be responsible for maintaining appropriate accreditations and maximising the value of benefits.

* **LECs, REGOs** **and embedded benefits** will be transferred to the offtaker and the calculation of the OLR will take this into account.

**Question – is it appropriate for these benefits to be automatically transferred to the offtaker?**

## Credit support

No credit support shall be necessary from companies with a rating of [ x ] or higher (or an equivalent). If the offtaker does not meet this required rating, they shall maintain credit support throughout the term of the PPA to cover at least the level specified in the *limitation of liability*. This shall be either:

• A Parent Company Guarantee (with a rating of [ y ] or higher); or

• A Letter of Credit from a financial institution with a rating of [ z ] or higher).

If the credit rating of the provider of the credit support falls more than one notch below the originally required level then the offtaker shall provide a replacement credit support document within [ ] days.

Given that a prolonged negative pricing scenario is expected to be extremely unlikely, and in the event we expect generators to be able to curtail production, we do not think it is necessary to require generators to provide credit support to cover negative price risk. We also do not think it is appropriate to require credit cover for the sunk costs of an offtaker entering into the PPA – any losses incurred as a result of could be socialised across all offtakers through the levelisation process.

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| **Questions:**   * **Do you agree with the types of credit support that the offtaker should provide?** * **What type of replacement credit support document would you see as most appropriate in the event that the credit rating of the initial provider of credit support falls below the required level?** * **Do you agree that the generator should not be required to provide credit support and that any costs incurred by the offtaker due to premature termination of the contract could be dealt with through the levelisation process?** |

## Forecasts and data provisions

To allow the offtaker to adequately mitigate the imbalance risk of the plant, SCADA access should be provided along with forecast of availability and notification of unplanned outages. The offtaker should have the ability to require the installation of equipment at the facility to assist in forecasting and data transfer to help manage imbalance risks. The costs of any such installation shall be met by the offtaker.

At the start of the contract the generator shall notify the offtaker of any schedule of planned outages and shall consult the offtaker on the timing and length of any additional planned outages during the term of the contract.

There are some key differences between the nature of the relationship between parties under the OLR compared to a commercial contract. First, there is no enduring relationship between the parties – the backstop PPA will run for one year. Second, there is less reputational incentive – if market conditions are such that the best deals available are through the OLR, the generator is guaranteed a contract regardless of how well they communicate with their offtaker. Therefore it may be appropriate to include additional incentives to ensure that the generator provides adequate information to the offtaker – failure to notify the offtaker of outages within the specified timeframes will result in the generator paying the offtaker the System Buy Price for the forecast generation for the 24 hour period following the start of an un-notified outage.

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| **Questions:**   * **Should we include a minimum specification for data systems to ensure compatibility?** * **Do you agree with the incentives on the generator to provide accurate information on availability and outages?** |

## Termination

The contract may be terminated by either party if the other party is subject to an ‘event of default’.

An ‘event of default’ may be:

* Either party:
  + being dissolved or becoming insolvent; or
  + being wound-up or liquidated.
* Either party failing to pay an amount due and such failure is not remedied.
* Either party failing to perform a material obligation and such failure is not remedied.
* Either party repeatedly or continuously failing to perform an obligation under the agreement.
* Either party being disconnected or de-energised during the commercial operations phase as a result of non-performance, and this continues for [ x ] days.
* A failure for any payments due to be made under the credit support mechanism, or either party failing to ensure adequate credit support.
* Either party providing false information to the other party.

In this case the non-defaulting party may notify the other party and Ofgem of a date on which the contract will terminate, which will not be less than [ x ] days from the date of the notice. This period shall match the time it takes to put in place a replacement backstop PPA.

Additionally, after a 6 month lock-in period at the start of the term, the generator would be able to terminate the contract with 2 months’ notice. This would provide some certainty for offtakers for them to invest in setting up the contact and integrating systems, but would allow the generator to take advantage of changes in the market. It would also help avoid stagnation of the market if too many generators became locked into OLR contracts that they were unable to get out of.

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| **Questions**   * **Are there other circumstances in which it should be possible to terminate the contract?** * **Are the timings of the lock-in period and break clause appropriate?** |

## Consequences of termination

If the offtaker is subject to the event of default the generator will be able to request a replacement backstop PPA with a different offtaker. Meanwhile there should be penalties for the defaulting offtaker to ensure the generator is not disadvantaged, and prevent them frustrating the mechanism. If the backstop PPA is terminated in this way it is assumed that the generator will spill power onto the system and take the System Sell Price. The credit support will be called upon to pay the generator the difference between the System Sell Price and the CfD reference price minus the discount.

If the generator is subject to an event of default the offtaker will be able to terminate the contract. In this case the penalties shall be calculated as a percentage of reasonable costs, proportionate to the remaining term of the contract. If the generator is unable to pay these costs, they will be shared across all mandatory offtakers through the levelisation process. If the generator is subject to an event of default they shall not be offered a replacement PPA under the OLR. This will be detailed in the access rules rather than in the PPA itself.

There is also a question of how the OLR could deal with persistent minor breaches of a generator’s obligations if they span more than one contract. The penalties for failing to notify outages may be sufficient to ensure compliance, meaning that it is unnecessary to monitor performance across contracts. The alternative would be for offtakers to report all minor breaches to Ofgem to maintain a record and take action if necessary.

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| **Questions:**   * **Are the penalties for default appropriate?** * **Does the OLR need to deal with persistent minor breaches spanning more than one contract?** |

## Limitation of liability

The limitation of liability for the offtaker should be calculated as the maximum reasonable revenue that the generator could receive from their power during the period from termination to being reallocated a new backstop PPA. This should be twice the revenue received for power during the previous equal length period (if the contract is terminated early in the term, this should be twice the revenue that would have been received under the terms of the backstop PPA for the plant’s metered output during the previous equal length period).

## Assignment

Neither party may assign or otherwise transfer any of the rights or responsibilities under the agreement without the written consent of the other party. The one exception to this should be that the generator shall have the right to transfer its rights by way of security to a lender and the PPA shall continue without change.

**Question – is this appropriate? Is there a requirement for a ‘direct agreement’?**

## Force majeure

The definition of Force Majeure will need to be defined separately; this clause sets out what happens following a Force Majeure event. As this is a backstop PPA which the offtaker is obliged to offer it is questionable whether there should be a minimum capacity, below which the offtaker can terminate the agreement. However, there may be times (e.g. competitive allocation) where the offtaker has voluntarily entered into the PPA based on the expectation that the generator will deliver a minimum capacity. It may be appropriate to align this with the Force Majeure Clauses in the CfD, which do not state a minimum capacity, but sets out that the affected party should take actions to reduce or mitigate the effect of the FM event and should communicate the date from which normal performance is expected to resume. There should therefore be no termination rights unless the generator fails fulfil its obligations under this clause, or is incapable to fulfilling any of its obligations under the PPA.

**Question: do you agree that there should be no minimum capacity for the generator?**

## Change in law

Any changes to the contract would be made by the Government and there is therefore no need for the parties to renegotiate terms following a change in law. To ensure bankability of the OLR, the regulations would state that the Government has an obligation, to the extent possible, to return the generator to the same position as prior to the change in law. This would be alongside a change to the levelisation process to ensure that suppliers are not unduly affected.

**Question – do you agree that no general change in law provision is necessary?**

There is a possibility that a specific change in law event which increases imbalance costs could be compensated for through an increase to the strike price within. However, there is likely to be sufficient notice for any systemic change to imbalance costs and any commensurate change to the strike price, to enable an offtaker to price the appropriate costs into their bid. We therefore do not think it would be necessary to change the discount during the term of a backstop PPA, however there may be a need to change the discount for future bPPAs.

**Question – Do you agree that there is no need to reopen a current backstop PPA following a change to the strike price to accommodate increased balancing costs?**

## Dispute resolution

It is not expected that this section would be significantly different from a typical commercial PPA. In the first instance any dispute in connection with this agreement will be referred to a Director of each party who shall meet, in good faith, within [ ] days to resolve the dispute. If the dispute is not resolved at such a meeting then the dispute will be referred to an independent expert to arbitrate. If the parties are unable to accept the expert’s decision the matter shall be referred to the Courts of England.

**Question – is there any reason why the normal procedures would not be appropriate?**

## Pricing schedule

The contract terms for the pricing schedule would be very similar to a commercial PPA. Whether the discount is a fixed £/MWh or a percentage discount will be discussed under the discussion on pricing.