ETHIO-SPOTLIGHT[1]

ISSUE 5: POWER PURCHASE AGREEMENTS ETHIOPIA

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1. General overview and background on the use of PPAs in Ethiopia

A Power Purchase Agreement (PPA), also known as an off-taker agreement, is the central contract for any independent power generation project and underpins power development including the development of the attendant infrastructure. It is a long-term agreement to purchase power – at specific quantities, specific price, specific payment terms, for a specific duration – and is intended to survive the lifecycle of the power project which is usually about 20 to 30 years. A PPA is a negotiated instrument which defines the parties, their rights and obligations, identifies and allocates various risks to the party most suited to mitigating the same. Additionally, it also defines the cash flow structure of the project and directly impacts bankability of the transaction.

As highlighted throughout this series, the national development blueprint in Ethiopia recognises infrastructure development as pivotal to spurring economic growth and development in the country in a number of key industries including energy and particularly, concerning its production, transmission and distribution. In this regard, Ethiopia has experienced an enormous power deficit on account of the high upfront costs of infrastructure development which have stagnated electrification. The World Bank estimated that 8700 MW generating capacity power plants would be needed between 2010 and 2020, requiring a doubling of generation capacity.[4] Therefore, leveraging private sector participation through the use of the PPA as an alternative solution to power infrastructure development and financing has become essential. To this end, the negotiation and use of the PPA is not new to the legal landscape in Ethiopia. Prior to the establishment of the

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[1]Ethio-Spotlight is a free 6-part series on topics that we as authors and in-country Fellows observe are of interest to the regional and international community. These articles are published with a view to collate and transmit information that may spark further engagement with our host-country and with the Oxford Policy Fellowship

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[4] Forster V. and Morella E. (2011), Ethiopia's infrastructure: A continental perspective, https://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5595 accesed 1st April 2021.

Public Private Partnership (PPP) legal framework, there were power projects that were procured and PPAs negotiated. These projects include Daewoo Aysha 60MW wind farm, Corbetti 500 MW Geothermal Power project, Encom 30 Mw temporary power plant, and Aggreko 30 MW temporary power plant.[5]

Notably, under the current PPP legal framework, a total of 18 in the current PPP pipeline are power projects with five hydropower projects, five wind power projects and eight solar projects, which pipeline projects are anticipated to have a total generation capacity of over 5000 MW of electricity. On 19th December 2019, the two maiden PPP solar power plant projects in Gad and Dicheto (with a combined generation capacity of 250MW)[6], procured by Ethiopian Electric Power (the Contracting Authority) through the Office of the PPP Directorate General, reached commercial close. The relevant PPAs were among the suite of documents negotiated in these transactions.

2. Who are the parties to a PPA, their roles, obligations and risk allocation profiles?

Essentially, a PPA is a contract primarily between two primary parties; on one hand there is the Power Producer/ Generator/ the Project Company (the seller) and on the other, the Power Purchaser/off-taker which is usually a state-owned utility.

Secondary parties to the agreement include the Host Government (which is usually represented by line ministries such as energy, finance, environment and land agency as well as key state departments such as the central bank, the tax authority and the attorney general among others), the Project Lenders (financiers), the Regulator (which exists for the primary purposes of tariff approval[7], in order to ensure parties' compliance with industry standards and to protect consumer interests), the Fuel Supplier, the Plant and System Operators, the Transmission & Distribution Company, the Construction company (also known as the EPC contractor) and at the extreme end of this supply chain, the Consumer which consists of both high and low-voltage consumers who are directly affected by the retained tariff/ price. In practice, some of these secondary parties may also be signatories to the PPA including project lenders and high-voltage consumers.

Regarding the obligations and risk allocation profiles of the parties under a PPA, they are broadly structured as follows: -

a) The project company has an obligation to arrange the investment and financing for the project and then leverage that financing to construct, operate and maintain the asset during the PPA term;

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[5] African Legal Support Facility, 'PPP Country profile- Ethiopia', https://www.aflsf.org/sites/default/files/PPP%20Country%20Profile%20-%20Ethiopia.pdf accessed 31st May 2021

[6] Jean Marie Takouleu, 'Ethiopia: Acwa Power secures Gad and Dicheto Solar Power Plant Contract', (Afrik 21, 19th September 2019) https://www.afrik21.africa/en/ethiopia-acwa-power-secures-gad-and-dicheto-solar-power-plants-contract/ accessed 31st May 2021

[7] The tariff refers to and encompasses the actual price that the off-taker pays to the project company for capacity made available and/or energy generated. The currency unit used is usually determined by regulation, availability of foreign currency, the currency of the EPC agreement, or the currency in which the loans are denominated.

b) The off-taker has the obligation to make payments to the project company for the capacity, availability and/or power delivered by the project and to ensure the transmission and distribution mechanisms are in place to evacuate the power produced;
c) The PPA also sets out the parties' agreement on how to test the power plant, resolve disputes, and handle major events like force majeure, default and termination of the contract;
d) There are also a number of permits, approvals and contracts associated with the PPA which need to be identified and then responded to accordingly and which form the subject of related agreements i.e. the direct agreements, the engineering, procurement and construction (EPC) agreements, the operation and maintenance (O&M) agreements, the land acquisition agreements, the grid-interconnection agreements and the fuel supply agreements among others etc.

In practice, it is interesting to note that the obligations do not always fall solely and/ or exclusively on one party alone. Rather, the obligations are often shared and shift from one party to another based on the location of and circumstances surrounding the power plant

3. Key clauses in a PPA

As stated above, a PPA is key to project bankability as payments from the buyer under the agreement are the sole income stream that the seller uses to repay its lenders on a timely basis.[8] A PPA also makes demand and pricing certain and establishes a long-term purchase obligation. For purposes of this paper, the key clauses in a PPA can be categorised as financial terms, risk allocation and mitigation terms, other terms, and default and termination terms.

3.1.Financial provisions[9]

The financial terms of a PPA are arguably the most important provisions of a PPA because a PPA is essentially a sale and purchase agreement.[10] The financial terms are based on a tariff structure (either capacity or non-capacity based) which determines the price and capacity of energy. To this end, the tariff must be clear and fixed for the duration of the PPA and any changes must be in accordance with adjustment mechanisms agreed to upfront in a binding agreement. Financial terms include; invoicing (governing the periodic issuance of invoices by the seller to the buyer to be paid for energy delivered and the applicable capacity charge in an agreed currency), metering (governing how energy and capacity shall be measured to facilitate invoicing), payments (governing the currency of payments, methods of payment and how late payments shall be dealt with) and credit support provisions (for the offtaker these support payment obligations e.g. partial risk guarantees, political risk guarantees, and escrow accounts to address offtaker liquidity, whereas for the project company these would govern the issuance of performance and development bonds to deter performance default).

[8] ALSF, Understanding Power Purchase Agreements, http://alsf.afdb.org/sites/default/files/resources/UnderstandingPowerPurchaseAgreements_Web%20Eng.pdf accesed 1st May 2021.
[9] ibid
[10] ibid

3.2.Risk Allocation and Mitigation terms[11]

A PPA must equitably balance and allocate risks between the contracting parties in order for the agreement to be successful and bankable. Risk, in a PPA, is allocated on the basis of the project financing principle of contractual allocation of risk which provides that risk should be optimally allocated to the party best able to manage such risk. It should be highlighted that while some risks would be present throughout the lifecycle of the project, others may only be present in the development or construction phase and others while the project is in operation. Examples of risks that exist throughout a project are force majeure, change in law, political risks, change in tax and change in control of the project company. Construction risks include site access, interconnection and testing, while development risks include failure to commence and land procurement. The risks that may exist in the operation phase include foreign exchange, fuel or feedstock, performance and market risk. While it should be emphasised that a risk may not fall solely and exclusively to one party in all projects/ circumstances, the seller would typically bear risks associated with its construction and operation obligations while the buyer typically bears the risk of lower than expected market demand through capacity payments or deemed energy payments.

The COVID 19 pandemic brought change of law and force majeure clauses at the fore with governmental shutdowns and restrictions of travel wreaking havoc on commercial contracts including PPAs,[12] and for this reason that the inclusion and careful drafting of these clauses in a PPA became ever so important. Change in Law can mean the introduction of a new law, modification of an existing law and changes in interpretation of a law by a court, tribunal or government entity. In a PPA the risk of a change of law would typically be borne by the offtaker or buyer and the change would be governed by a stabilisation clause which would ensure that the seller should be made economically whole in the event of a material change in law. Force Majeure clauses must clearly define the meaning of a force majeure and its consequences. It allocates the risk of loss if performance is delayed, hindered or prevented and would release the seller or the offtaker from obligations beyond their control which could not have been reasonably foreseen. The clause typically has the following defining features; the event must have a materially adverse impact on a party's ability to discharge their obligations under the PPA, the event must not be the fault of the party seeking relief and must be beyond their reasonable control and the event must be one that could not have been reasonably foreseen by the parties nor could reasonable measures have been implemented by a diligent party to avoid or mitigate the risk. Should a force majeure event occur, a party to a PPA can seek relief from its contractual obligations as a result of a force majeure.Examples of force majeure events include, but are not limited to, riots, civil disorder, a pandemic, acts of terrorism, floods hurricanes or earthquakes.

3.3.Other PPA terms[13]

Other relevant terms that are found in a PPA include dispute resolution (providing for a number of mechanisms to prevent termination of the PPA including mediation and arbitration, and in some

[11] ibid
[12] American Bar Association, The importance of force majeure clauses in the Covid 19 Era, https://www.americanbar.org/groups/litigation/committees/commercial-business/boilerplate-contracts/force-majeure-clauses-contracts-covid-19/ accessed on 1st June 2021.
[13] ibid 7

circumstances the parties may have recourse to a court), term and expiration of the PPA (the term should be long enough to allow the sellers debt to be repaid and when the PPA term expires the parties can agree to transfer. sell or decommission the plant), local content (laws and policies to bring linkages between foreign investment and domestic markets), confidentiality, boilerplate provisions (including limitation of liability, indemnification and governing laws).

3.4.Default and Termination[14]

These include events of default (governing buyer's events of default and non-default events), Lender's rights (including step in rights, novation/substitution and Direct agreements), and post termination remedies (including Put and call option and Purchase price on termination)

4. Conclusion

A PPA is essential for Independent Power generation projects, particularly for developing countries with massive power deficits. To this end, a well negotiated PPA featuring optimal risk allocation is key to achieving project bankability and allows the offtaker to reduce electricity costs; the benefits of which can potentially trickle down to the end consumer. Furthermore, the COVID-19 pandemic which gave rise to disruptions that resulted in litigation on the potential application of force majeure clauses, has highlighted the importance of parties fashioning allocation of risk rationally to ensure that the party best placed to manage a risk bears it. This will ensure that PPAs, which are designed to be long term in nature, can withstand crises during their lifetime and that ultimately ensure the success of independent power projects.

[14] ibid 7