

MDA PRESENTS



FIRST AID FOR CONTRACTS



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RENEWABLE ENERGY PROJECTS - KEY PROVISIONS OF THE PPA

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In October 2021, the Department of Mineral Resources and Energy announced the preferred bidders for the Bid Window 5 of the REIPPPP (Renewable Energy Independent Power Producer Procurement Programme), which provides for new generation capacity of 2583 MW made up of 12 wind energy projects totalling 1 608 MW and 13 solar photovoltaic (PV) projects totalling 975 MW. In terms of the latest timelines announced by the Department, the contractual agreements necessary to implement these projects are expected to be finalised between July and September 2022.

These contractual agreements include a Power Purchase Agreement (PPA) in terms of which, the preferred bidder (now the seller) will sell the energy ultimately produced to Eskom (the buyer) over a specified term. The seller will typically also enter into

a series of agreements including with its lenders, an EPC (engineer, procure construct) contractor and an operator, for the funding, construction and operation of the power generating facility.

PPA is a generic term for the agreement governing the buying and selling of energy. Different considerations apply to the different types of renewable energy projects, but there are certain common PPA provisions which are generally form part of a PPA in South Africa. A few noteworthy key provisions are:

1. Electricity Generation License

The seller must obtain an electricity generation license permitting it to operate, generate and sell energy.

2. Distribution Agreement

The seller must enter into a distribution agreement with Eskom's transmission division or an entity to which such function is delegated, prior to conclusion of the PPA.

3. Project Site

The seller must procure the use and possession of the project site, whether through a lease or the purchase of the land. The seller will be responsible to Eskom for the suitability and condition of the project site, including climatic, environmental, and geotechnical conditions.

4. Construction

The seller must procure the construction of the facility on the project site. Eskom will be entitled to terminate the PPA if the seller does not ensure the commencement of construction within a stipulated period.

5. Term

The term ends on the earlier of termination or the expiry date. The expiry date will be a period (e.g. 20 years) after the scheduled commercial operation date. The commercial operation date (actual) is when the power generating facility becomes operational. The scheduled commercial operation date (programmed) may be extended for reasons stipulated in the PPA, but will not necessarily be the same date at the commercial operation date. The operational period is

from the later of the commercial date or scheduled commercial date to the end of the term.

Should the scheduled commercial operation date be earlier than the commercial operation date, the seller effectively forfeits a period of the operational period during which it could be selling power to Eskom.

In addition to this, for every day that the commercial operation date is delayed beyond the scheduled commercial operating date, the operational period is reduced by an additional day and the expiry date is brought forward by one day.

The seller thus suffers a threefold loss for one day of delay to commercial operation.

The contract with the EPC contractor will typically make provision for delay liquidated damages to compensate the seller for any delay occasioned by the actions of the EPC contractor.

6. System Events and Compensation Events

The scheduled commercial operation date can be extended by system events, compensation events and force majeure. A system event is a failure to connect the facility to the distribution system, which cannot be attributed to the seller. A compensation event (somewhat unusually defined) is a breach by Eskom.

7. Contracted Capacity

The seller contracts with Eskom that the facility will be able to achieve a certain power capacity. If at the commercial operation date, this capacity is lower than contracted (but above the minimum capacity stipulated e.g. 50%), the contracted capacity is reduced to the actual achieved capacity and the seller is not permitted to change it at a later stage.

The practical effect of this, is that the energy the seller is able to sell to Eskom is reduced, impacting on the seller's ability to generate income.

The contract with the EPC contractor will typically make provision for performance level and consumption level liquidated damages to compensate the seller for any loss of capacity occasioned by the actions of the EPC contractor.

8. Fast Track Dispute Resolution

Dispute resolution is by way of internal referral to representatives of the parties, followed by either court proceedings or arbitration. This is a fairly standard option as far as dispute resolution clauses go.

Specific to the PPA (and other supporting contracts e.g. with the EPC contractor and operator), however, is the alternative process of fast track dispute resolution. It is an expert determination, allowing the parties only a short period to make submissions to the expert and the expert to make a decision, which is final and binding.

The PPA will stipulate which disputes may be referred to fast track (instead of internal referral and court proceedings/arbitration), however, allowing disputes to accumulate beyond what is capable of determination by the expert in a short period of time will defeat the purpose of this provision.

The PPA has a unique and complex risk profile. The seller takes on risks which in the usual standard term construction contracts would be associated with an employer or client, while at the same time incurring penalties for any failures to have the power generating facility up and running on time and to the required capacity. A seller seeking to recover these losses from its EPC contractor or operator, will often be faced with a denial of liability and a round of finger pointing making it difficult to determine which party it should seek to recover from.

The complexity of the PPA and the serious financial consequences following a misstep make it vitally important for all parties (including EPC contractors and operators) to fully understand and appreciate their obligations and the risks associated with these obligations prior to entering into any agreement. Expert advice should be sought to assess and understand the commercial and technical risks that are envisaged.