Chapter 7

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Drafting and Negotiating Power Purchase and Sale Agreements

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Synopsis

§ 7.01. Introduction.

Today, it is common that the owners of power generation facilities attempt to contract with long-term purchasers of the power generation through a "power purchase agreement." These power purchaser agreements are frequently well over one hundred pages long (including appendices and attachments). Because these power purchaser agreements are generally the only source of revenue for the developers of such facilities, it is critical to the developer/owner that such agreements are drafted and negotiated with great care. Generally, these facilities are "project financed." This generally means that the financing is usually structured such that the lender's recourse is against the project revenues only. The power purchase agreement is then the source of loan repayment. As such, the lender takes a critical look at this agreement as well.

The power purchase agreement is then the cornerstone of development of a power generation facility. Whether you represent the developers of such facilities, lenders to such facilities, fuel suppliers to such facilities, contractors or equipment suppliers to such facilities or potential investors in such facilities, a knowledge of the terminology, risks and issues encountered in such agreements is crucial to the effective representation of your clients.

In 1993, the author addressed the Eastern Mineral Law Institute's 14th Annual Institute and presented a paper on the subject of Drafting of Power Purchase Agreements with Independent Power Producers ("the

1993 Article").[1] That paper focused on the development of the market for long-term power purchase agreements and risk apportionment between buyers and sellers under such agreements.

This chapter will focus briefly on the changes that have taken place in the market place since 1993 and focus in more detail on the issues to be addressed in a current power purchase agreement.

As discussed in the 1993 paper, a power generation facility was generally only developed if the developer executed a long-term power purchase agreement with a utility for the output of the facility.

In the mid and late nineties, deregulation changed the approach. The mere forecast of possible deregulation led utilities to begin resisting any long-term commitments. It became increasingly difficult to find a utility that could make a long-term commitment. The utilities were not certain of what treatment such contracts would receive in the oncoming deregulation.

It was generally believed that the era of the long-term power purchase agreement was over. Most attorneys practicing in this area and developers developing the projects for which the power purchase agreements were negotiated believed that long-term sales were a thing of the past. Deregulation, it was believed, had ended the need for long-term power purchase agreements. The literature in this business discussed the development of "merchant plants." The merchant plant would be a plant developed by a speculator who would build a plant to sell into the market on a short term basis. Short term trading would take the place of single long-term contracts.

By about the year 2000, entities that developed power projects sometimes were entities that traded in power on a daily, weekly or monthly basis. Trading, however, is very risky. Not all developers were interested in the volatile trading business. There are entities in this business who are in the business of developing power plants to sell "availability." They are now succeeding in finding a long-term buyer of their output. The contracts are generally for a long-term period of 20 or 25 years. The entities obtained

1 14 *Eastern Min. L. Inst*. ch.18 (1993 Eastern Mineral Law Foundation).