

CHAPTER 18

Drafting Power Purchase Agreements with Independent Power Producers

Mark J. La Fratta

McGuire, Woods, Battle & Boothe

Richmond, Virginia

Synopsis

§ 18.01. Origin of Non-Utility Power Industry.

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[b]--Avoided Costs.

[c]--Cogeneration.

[d]--Small Power Producers.

[2]--Independent Power Producers.

[a]--Federal Power Act Pricing Approval.

[b]--Public Utility Holding Company Act.

[c]--State Public Utility Laws.

[3]--Energy Policy Act of 1992.

[a]--Electric Wholesale Generators.

[b]--Transmission.

§ 18.02. Contract Types and Philosophies.

[1]--Standard Offer Contracts.

[a]--What Are They?

[b]--Advantages for the Purchasing Utility.

[2]--Disadvantages.

[3]--Negotiated Contracts.

[a]--What Are They?

[b]--Advantages.

[c]--Disadvantages.

[4]--Competitive Bid (RFP Contracts).

[a]--What Are They?

[b]--Advantages.

[c]--Disadvantages.

[5]--Dispatchable Contracts.

[a]--In General.

[b]--Features.

[c]--Credit Ratings.

§ 18.03. Risk Shifting in Dispatchable Power Contracts.

[1]--What Risks Are Shifted?

[2]--How Risk Is Shifted to NUG Operator.

[a]--Cost Overruns.

[b]--Operating Costs (Other than Fuel).

[c]--Environmental Regulations.

[d]--Fuel Availability.

[e]--Demand for Energy.

[f]--Delay/Late Completion.

[g]--Failure of Project/Cancellation.

[h]--Operating Liability.

[3]--What Risks Remain With The Utility?

[a]--Demand for Capacity.

[b]--Market Price of Fuel.

[c]--Breach of Contract by Operator.

[4]--Utility Protection Where It Has Risk.

[a]--Need for Capacity.

[b]--Market Price of Fuel.

[c]--Operator Breach.

[d]--Insurance.

§ 18.04. Pricing Structure.

[1]--Capacity Payment.

[2]--Fixed Operating and Maintenance Costs.

[3]--Variable Operating and Maintenance Costs.

[4]--Energy/Fuel Costs.

[a]--Fixed Escalators.

[b]--Fuel Market Indexing.

[c]--Utility Fuel Cost Indexing.

§ 18.05. Conclusion.

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§ 18.01. Origin of Non-Utility Power Industry.

[1]--Public Utility Regulatory Policy Act.

In the mid-1980's, the emergence of a new energy industry component began to change the electric utility industry. That new component has been called "cogeneration," "independent power," "private power," and, more recently, "non-utility generation." None of these terms adequately describes the entirety of this new business. Because of this new business, large segments of the new capacity now being constructed to serve electric customers in this country will be neither owned nor operated by *traditional regulated utilities* with rates of return governed by a utility regulatory commission. That is why "non-utility generator" (NUG) is the best name for this component, despite the fact that some NUGs are considered "utilities."⁽¹⁾

While this component did not become nationally significant until the mid-1980's, it was born, or at least conceived, in the late-1970's. It is one of the legacies of the Carter Administration. When James Earl Carter was elected President of the United States, the country was still feeling the effects of the Arab Oil Embargo of 1973. In response to President Carter's recommendation that Congress develop a national energy strategy, Congress passed the National Energy Conservation Policy Act of 1978.⁽²⁾ This Act included something known as the Public Utility Regulatory Policies Act of 1978⁽³⁾ (PURPA).

[a]--Qualifying Facilities.

PURPA created a class of power generation facilities with rights to sell power to regulated utility companies. It amended certain sections of the Federal Power Act,⁽⁴⁾ removing, among other things, many statutory barriers to entry into the power market.

Title II of PURPA required non-regulated utilities (such as municipal utilities) and state regulatory commissions to consider several standards, including basing rates on cost of service, eliminating declining block rates, establishing time-of-day rates, considering seasonally differentiated rates, and evaluating interruptible rates and load management techniques.⁽⁵⁾ Title II also described this new class of electric power generation facilities and the characteristics and standards for facilities to "qualify" for certain benefits. Chief among these benefits is the right to force utilities to purchase the facilities' electric output.⁽⁶⁾