Renegotiating Power Purchase Agreements

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Why do we want to renegotiate or change PPA's?

- Because the seller cannot perform
- Because the buyer cannot pay
- A better method than traditional PPAs

In Asia today, the major reason for this step is that the buyer cannot pay

To improve short term cash flow the buyer (utility) can

- Increase revenues
- Decrease costs

Increase Revenues

- Raise electricity tariffs
- Increase volume or production
- Reduce losses (transmission or administrative)

Raise Electricity Tariffs

In many countries of the Asian region, this is out of the control of the public utility - it is often a political decision

For example the current tariff in Indonesia is less than 2 cents/kWh

Increase Production of Electricity

- Currently many Asian countries have a generation overcapacity (often because transmission and distribution development has lagged behind power generation) - regulatory bodies have been slow to react to the changing dynamics of the electricity sector

- Another way to increase production is to take over the existing “captive” power that industry has installed because of the inability of the public utility to perform in a timely and significant manner.

  For example, in Indonesia, the captive power sector accounts for 40% of the country’s power generating capacity

Decrease Costs

- improve efficiencies within the organization
- improve demand side management
- better manage foreign denominated fuel supply
- “deal” with foreign currency denominated electricity supply - commonly the IPP
  - ***in other words, renegotiate the PPA***

Existing Power Purchase Agreements

- In most developing countries there is often no formal agreement between the state-owned generating company and the buyer

- However, the more “liberalized” countries have developed PPAs with state-owned gencos; such as EGCO in Thailand

Asian Crisis Analysis Conclusions & Implications (1)

- Regional political leadership will see substantial change
- Despite the current currency woes, the underlying economic strength of the region is sound
- Primary energy demand growth rates and the growth in electricity demand will be the highest of any major world region over the long term

Asian Crisis Analysis Conclusions & Implications (2)

- Major additions and improvements in energy infrastructure will be required to meet the growing energy demand
- Environmental concerns will grow but will remain secondary to industrial growth and job creation
- The region will be an energy technology follower
- Coal will remain the dominant fuel in the powergen sector

IPPs are not all the same

- Is the IPP a short term player or is it in the country for the long haul ?
  - Does the IPP believe that the current Asian crisis is only a temporary setback and that the host country will eventually grow and honor its commitments
  - How much exposure does the IPP have ?
    - » Actually producing
    - » Physically under construction
    - » Civil works underway
    - » Land has been acquired
    - » Are still in the "development" phase
- What type of exposure ?
  - Political
  - Financial

Renegotiation

- Does the Agreement allow such a step?
- If arbitration is needed, where is the location and how enforceable is any decision?
- What are the Force Majeure conditions?
- Can the company physically move the assets?
- What is the relationship with joint venture partners
  - are all JV partners and shareholders financially capable?
- What are the negotiable elements?
- Should the Government or utility renegotiate PPAs separately or have a consistent methodology?
- Should the IPPs insist on such a consistent methodology?
- Should the IPPs play hardball or be conciliatory?

PPA Elements

- Payment structure
- Incentive for capacity availability
- Heat Rate issues
- Capacity payments, energy payments
- Obligations to take and pay, take or pay
- Non-performance
- Force Majeure
- Allowances for scheduled & non-scheduled maintenance and outages
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- Non-performance by suppliers
- regulatory risk allocation
- Performance criteria
- Milestones and associated bonuses/penalties
- Penalties for availability shortcomings
- Baseload vs. dispatchable or peaking capacity
- termination events
- Purchase/control rights by utility
- Third party sales
- Interconnect, transmission and similar agreements
- Arbitration

Negotiable Elements (1)

- **Price**

  This is often the most politically expedient element to negotiate

  – Capacity Payment
    - » construction
    - » transaction costs
    - » interconnection costs
    - » taxes
    - » major overhauls
    - » start-up costs development costs
    - » interest during construction
    - » future improvement projects

- **Fixed Operating and Maintenance Costs**

- **Variable Operating and Maintenance Costs**

- **Energy/Fuel costs**
  - •Fixed escalators
  - •Fuel market indexing
  - •Utility Fuel Cost Indexing

Negotiable Elements (2)

- **Timing**
  - postponement of project, with some undertaking from the Government that regulatory/tariff issues will be addressed in a timely manner
- Minimum Take
- Capacity Factor
- Modifications to configuration
- Do not forget other negotiable elements
  - performance bonds
  - import duties
  - tax “holidays”
  - more lenient land access arrangements

Negotiable Elements (3)

And of course, currency!!

Major Negotiating Ground Rules

- Know what you want
- Know who you are negotiating with
- Know what they can give you
- Assess your bargaining power
- Think constructively
- Know what is important
- Deal with the Deal-Breakers
- Don’t make the contract so good that it is bad
- Define your terms
- Know when to use precedents, when to break with tradition and when to say you don’t know
- Prepare the Document

What can the Government Offer?

- Realistic Supply/Demand Forecasts
  - Scenario Planning
- Existing IPPs will obtain favorable treatment in the future
  - e.g. A moratorium on any new companies for the next ?? years
- Greater transparency in the business
  - Thailand has had on open tender system for IPPs, whereas Indonesia has chosen not to use this methodology
- A planned approach to tariffs and tariff movements, dispatchability and payments
- A willingness to negotiate other elements from other Ministries, such as taxation, customs
- A commitment to deal with its own internal problems, such as high costs, further loss of market to captive power, currency movements

Where is the Industry Going?

- Changes from monopolies (and monopsonies) to IPPs to merchant plants and pooling

- Regulatory issues need to be dealt with in a contemporaneous fashion

Other Questions

- Should cancellation costs be shared between IPP developer and the Government ?

- Will they reimburse the fuel supplier ? Or will this need to be renegotiated concurrently?

- Is there a “buy-out” clause?