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What is a Power Purchase Agreement (PPA)?

A Power Purchase Agreement (PPA) is a legal contract between an electricity generator (seller) and a power purchaser (buyer). The PPA defines all the commercial terms for the sale of electricity between the seller and the buyer. Typical terms of the PPA include: commissioning process, commencement of commercial operation of the project, performance terms, schedule for delivery of electricity, curtailment terms, penalties for under delivery, payment terms, operation, metering and maintenance, termination, milestones and defaults, force majeure, insurance, etc.

A PPA is a principal agreement that defines the revenue and credit quality of a generating project and is thus a key instrument of project finance. Securing a PPA is usually a condition to any equity and debt financing of a project.

The seller under the PPA is typically an independent power producer or "IPP". The seller is the entity that owns the project. In most cases, the seller is organized as a special purpose entity whose main purpose is to facilitate non-recourse project financing.

The buyer under the PPA is typically a utility that purchases the electricity to meet its customers' needs.

The PPA is considered contractually binding on the date that it is signed, i.e. the effective date. Once the project has been built, the effective date ensures that the purchaser will buy the electricity that will be generated and that the supplier will not sell its output to anyone else except the purchaser.

Before the seller can sell electricity to the buyer, the project must be fully tested and commissioned to ensure reliability and comply with established commercial practices, after which the commercial operation date will kick off and the seller can start producing electricity for sale.

The termination of a PPA ends on the agreed upon commercial operation period. A PPA may be terminated if abnormal events occur or circumstances result that fail to meet contractual guidelines.

Most PPA's are structured as "take-or-pay" agreements; which means that the buyer will pay the seller not only for electricity actually delivered to the point of delivery but also for "available capacity" or energy that would have been delivered but for the curtailment. Curtailment provisions are very important because they can directly impact the required pricing or profitability of the project.

Some of the benefits of the PPA include: it provides guarantees as to quantities purchased and price paid, thus making the project viable, certainty of long term revenue stream for the seller, protection from cheaper or subsidized domestic or international competition, security of supply for the buyer.

One key benefit of the PPA is that by clearly defining the output of the generating assets and the credit of its associated revenue streams, a PPA can be used by the PPA provider to raise non-recourse financing from a bank or other financing counterparty.

Negotiating and securing an acceptable PPA is an essential step in developing electricity projects and should not be entered into without the advice of experienced legal counsel.