

OFFICE OF GAS AND ELECTRICITY MARKETS

ECONOMIC TERMINATION OF NFFO/SRO CONTRACTS

Introduction

- 1.1 This note briefly outlines the procedures that Ofgem has adopted to determine whether a NFFO/SRO contract can be terminated on the grounds of economic viability. Please note that, if the particular circumstances of a case make it appropriate to depart from these procedures, then we shall do so. We may occasionally revise these procedures.
- 1.2 Anyone interested in pursuing an economic termination should:
- read this document;
 - notify Ofgem's Manager of CCL, REGO and NFFO (Rebecca Dixon: Rebecca.Dixon@ofgem.gov.uk or 020 7901 7409) of the situation; and
 - submit the request for economic determination in the form of hard and electronic copies of all relevant documents.

Grounds for economic termination

- 2.1 The NFFO/SRO contracts allow a generator to request that the contract be terminated, on the grounds that it is no longer, or can reasonably be expected no longer, to be economically viable. A request for economic termination can be made where certain specified conditions result, or can reasonably be expected to result, in increased costs or reduced revenues so material as to make the scheme uneconomic.
- 2.2 In seeking economic termination, the generator must adduce evidence sufficient to satisfy four tests. These are that:
- a change, or damage/destruction, or an event or circumstance has occurred consisting of one or more of:
 - a change in law;
 - a Force Majeure event ;
 - a material (to the scheme) adverse change in national or international financial, political, industrial or economic conditions;
 - material damage to or destruction of the scheme (other than a deliberate act or intentional omission of the generator)

 - an event or circumstance which is inconsistent with any original assumption made about the costs attributable to the financing, construction or operation of the scheme and which is outside the generator's reasonable control; and/or

- an event or circumstance which is inconsistent with any original assumption made about the physical or technical conditions necessary for construction or operation and which is outside the reasonable control of the generator;
- that the resulting increased costs or reduced revenues are material;
- that the generator made reasonable endeavours to prevent such an occurrence; and that
- the generator used reasonable endeavours both to reduce or mitigate the effects of the occurrence and to establish whether any practicable alternative course of action is available for fulfilling the contractual obligations.

Submission and timescale

- 3.1 The generator must send written notification of the request for termination to Ofgem and the NFPA (for NFFO contracts). Where an SRO contract is concerned, notification should go to NFPA (Scotland), rather than to the NFPA. The request must be made on the basis of the existing contract (i.e. not on the basis of anticipated or hypothetical contract amendments). Any previously-agreed contract amendment must be indicated.
- 3.2 Ofgem has three months in which either to determine whether the station remains economically viable or to request further information or evidence, including expert evidence. If Ofgem neither rejects the generator's case, nor requests evidence, within that three-month period, the generator will become entitled, as of right, to terminate the contract. Where Ofgem has requested evidence, the three-months period will run from the date of Ofgem's receiving all of that evidence. Until the three-month period expires, there is nothing to prevent Ofgem from making further requests for evidence - on receipt of which a further three-month period would begin.
- 3.3 In respect of receipt of documents, we shall observe the same requirements as the relevant contract for notices given by the generator to the other party to the contract. We shall accept e-mails (and, indeed, we prefer to receive the completed questionnaire by e-mail), and will treat emails as being received on the day that we actually receive them. Expert evidence must be signed, and must therefore be sent by hard copy (first class post).

Procedure

The questionnaire

- 4.1 We shall re-run the economic test used as part of the "will secure" test for NFFO/SRO. In so doing, we shall make such adjustments as we consider appropriate to take account of contract amendments. We shall ask the generator to complete a questionnaire based on that used for the original economic test. We may challenge any of the figures used by the generator in the completed questionnaire and may

request further evidence.

- 4.2 The generator should fill in the figures for each of the cost fields in the questionnaire, indicating whether these are revised from the figures given in their original bid. This should also include any cost reduction. The generator should submit clear quantification and justification, as well as evidence, for each of the revised cost figures¹.
- 4.3 The questionnaire should, as well as taking into account the generator's valuation of the electricity price over the period between the end of the contract life and the scheme life, take into account the value of ROCs and/or LECs over that period. It should also take into account the value of any other electricity and ROCs / LECs to which the generator would be entitled – in particular, Additional Metered Output and associated ROCs and/or LECs.
- 4.4 We shall use a figure of £30 (subject to RPI) for ROCs (on the assumption that the Renewables Obligation targets are met and that the Renewables Obligation will continue to 2027). We shall use a figure of £4.30 for LECs. These figures are purely indicative and are subject to change. These figures are given solely for the purposes of the NFFO / SRO economic viability test. They are not intended for any other purpose, and should not be relied on for any other purpose. If a generator considers that a different figure should be used in their case, they should provide justification for that view.
- 4.5 We shall then run the completed spreadsheet against the standard economic model to ascertain what the net present value is over both the contract life and the scheme life. This test will take into account all costs involved in the project including capital costs.
- 4.6 In assessing the rate of return, we shall use a discount rate of 7.5%. However, it is open to the generator to propose a different rate. Such a proposal must be justified to our satisfaction. We shall also check whether the generator made a declaration (at the time of the original will-secure test) that they were willing to accept a lower rate of return (because of other benefits attached to the project)².

Demonstration of reasonable endeavours

- 4.7 The generator will have to provide proof that they have used reasonable endeavours to prevent and reduce or mitigate the effects of the occurrence in question. They will also have to establish whether any practicable alternative course of action is available. Such proof might, for example, include (but would not be limited to):
- the possibility of relocating the project under the Locational Flexibility Order;
 - the options for treating or cleaning gas, as a solution to problems of gas quality; or

¹ For example, where the generator is maintaining that equipment costs have increased, the submission should be supported by at least three quotes as evidence of this - or evidence why fewer quotes are available.

² If the generator had made a rate of return declaration, the generator will not only have to demonstrate that the net present value is negative over both the contract and the scheme life, but also that the net present value is materially less than the net present value at the time of the bid.

- purchase of purchase second-hand equipment.

Independent reports

- 4.8 Generators may be required to provide reports from an appropriately qualified expert. This might, for example, be in support of a case for a different discount rate or where the generator claims that reduced output is affecting economic viability.

Assessment of submissions

- 4.9 We shall consider each request, case by case, on the particular facts. To ensure consistency, and to assist in decision making, Ofgem staff in London and Scotland will work closely together.

Outcome

- 5.1 We shall inform both the generator and the NFPA, in writing, of the outcome. If the outcome indicates that the net present value is negative over both the contract and the scheme life, the generator will be able to terminate their NFFO/SRO contract for economic reasons. If the outcome indicates that the net present value is zero or positive over either the contract or the scheme life, the generator will not be able to terminate their NFFO/SRO contract for economic reasons.
- 5.2 Should we consider the project to be viable, on the basis of the evidence presented, we shall give the generator an opportunity to provide a financial assessment of the project. This assessment should be from an appropriately qualified expert and should support the use of a particular value, assumption, or number. If such an assessment is received and it states that the generator's project is not or would not be financially viable, we shall give due consideration to the assessment.
- 5.3 A determination that the project remains economically viable will not prevent the generator from putting in a further request for economic termination - at a later stage. Relevant factors may change significantly, over time.

Additional Considerations

- 6.1 The economic termination provision under the relevant clause of a NFFO or SRO contract is not applicable to any situation when any of the conditions in clause 2 "Conditions to Commencement of the Contract Term" of the contract are not fulfilled. If any of the conditions is not fulfilled, there is no entitlement to produce a statement to Ofgem under the termination clause.
- 6.2 If any of these conditions is not fulfilled, the matter is not one of economic termination, but one of non-fulfilment of a condition precedent. If a condition precedent is not fulfilled, the contract may lapse. This is a matter which should be raised with NFPA/NFPA Scotland as counter-party to the contract.