

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 remains economically viable.
- 1.2 Ofgem's role within the relevant parts of the NFFO/SRO contracts is to express an opinion as to whether a scheme is viable on economic grounds.
- 1.3 Please note that, if the particular circumstances of a case make it appropriate to depart from the procedures outlined in this note, then we shall do so. We may occasionally revise these procedures.
- 1.4 Anyone interested in pursuing an economic termination should:
 - contact NFFA / NFPA (Scotland) in connection with the proposed termination;
 - read this document;
 - notify Ofgem's Manager of NFFO (Florence Simon-Hart: florence.simon-hart@ofgem.gov.uk or 020 7901 7352) of the situation; and
 - submit to Ofgem the statement required by the SRO/NFFO contracts which indicates their wish to exercise economic termination, together with all relevant evidence, in hard and electronic form.

Background: grounds for economic termination

- 2.1 The NFFO/SRO contracts provide that generators may give notice to NFFA / NFPA Scotland that the contract is terminated. One ground on which termination may be effected is where certain specified conditions result, or can reasonably be expected to result, in costs being increased or revenues being reduced so materially from those contemplated at the time of the making of the contract that the scheme is uneconomic.
- 2.2 Economic termination may be sought where the following apply:
 - 2.2.1 an event or circumstance has occurred consisting of one or more of:
 - a change in law; or
 - a Force Majeure event; or
 - a material (in the context of the contract insofar as it relates to the facility or proposed facility) adverse change in national or international financial, political, industrial or economic conditions; or
 - material damage to or destruction of the facility (other than a deliberate act or intentional omission of the generator); or

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

Further, all of the following must be applicable:

- 2.2.2 the generator used reasonable endeavours to prevent 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; and
- 2.2.3 the result of the occurrence is, or can reasonably be expected, to increase certain costs to the generator or reduce certain payments to be earned by the generator so as to render the facility uneconomic. The assessment of whether the facility is uneconomic is arrived at by taking account of specific costs and revenues so as to arrive at a real net present value for the facility; and
- 2.2.4 the generator has delivered to Ofgem and the NFPA / NFPA (Scotland) a statement indicating its wish to exercise a right of termination: and has delivered to Ofgem such supporting evidence as Ofgem may reasonably require; and
- 2.2.5 Ofgem has not, within three months of receipt of that statement, notified the generator and NFPA / NFPA (Scotland) that the evidence provided to it does not show that the scheme has become uneconomic.

Submission of statement requesting termination and timescale

- 3.1 The generator must send written notification indicating its wish to exercise a right of 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 notification 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 express an opinion that the station remains economically viable or to request further information or evidence, including expert evidence.
 - 3.2.1 If Ofgem neither rejects the generator's case, nor requests evidence, within that three-month period, the generator will be entitled to take any remaining steps as against the NFPA / NFPA (Scotland) that may be necessary for it to terminate the contract for economic reasons without further reference to Ofgem. Please note that if the NFPA / NFPA (Scotland) is satisfied that the relevant remaining contractual criteria for economic termination are met, the contract cannot terminate any earlier than the end of the month which follows the expiry of the three month period.
 - 3.2.2 Where Ofgem has requested evidence, the three-month 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 When assessing statements indicating a wish to pursue economic termination and all relevant supporting evidence, Ofgem's approach incorporates the economic test used as part of the "will secure" test for NFFO/SRO. Further, we shall make such adjustments as we consider appropriate to take account of contract amendments. We shall therefore 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 generator's response 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

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.

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.

Relevance of other matters

- 4.7 NFFO / SRO contracts do not provide a specific role for Ofgem in determining those matters summarised in paragraphs 2.2.1 – 2.2.3 above. Further, as noted above, Ofgem’s role is in the provision of an opinion as to whether a facility has become uneconomic. However it may be necessary for Ofgem, in assessing whether a facility has become uneconomic, to have regard to one or more of the matters provided for in the contracts and summarised in paragraphs 2.2.1 – 2.2.3 above. In the event that this should be necessary, Ofgem will take account of the views of the parties to the contract when assessing these criteria. In the event that the parties are unable to agree whether these contractual criteria are satisfied, Ofgem would ordinarily expect that dispute to be referred to arbitration in accordance with the relevant statutory mechanism.

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 NFFA, 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 take any remaining steps as against NFFA / NFFA (Scotland) that may be necessary for it to terminate the contract for economic reasons without further reference to Ofgem. 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 economically 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.

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.

- 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 If any of the conditions in clause 2 "Conditions to Commencement of the Contract Term" of the contract are not fulfilled then the validity of some provisions of the contract may be affected. Although such circumstances do not prevent the generator from applying for economic termination, in some cases it may be more appropriate for this matter to be raised with NFPA/NFPA Scotland as counter-party to the contract.

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