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Why Must the Project Company Only Sell Its Power into the Wholesale Market in a VPPA?

Mar 14, 2022

Reading Time : **2 min**

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The basic payment terms in a VPPA are a formula: Fixed Price minus the Floating Price, where (a) the Fixed Price is a set $/MWh price, and (b) the Floating Price is the variable wholesale price. If the Floating Price is greater than the Fixed Price, the Project Company will owe the difference to the C&I customer. If the Floating Price is less than the Fixed Price, the C&I customer will owe the difference to the Project Company. The Fixed Price is typically set to where, more often than not, the C&I customer is expected to receive more money from the Project Company than the C&I customer has to send to the Project Company.

A fundamental principle underlying the payment term in VPPAs is that the Project Company receives the wholesale price (that is, the Project Company receives the Floating Price) from the wholesale market through its physical sale of electricity into the wholesale market. This is primarily what ensures that the Project Company can pay the C&I customer if the wholesale price (i.e., the Floating Price) is greater than the Fixed Price.

If all or a portion of the electricity produced by the Project Company can be physically sold, instead, at a fixed rate to another customer (that is not the wholesale market), the creditworthiness of the Project Company will be jeopardized due to its payment obligations under the VPPA:

1. First, a mismatch will be created between the $/MWh price the Project Company will receive from such third party sale versus the wholesale price. For example, if the wholesale price is $50/MWh (and greater than the Fixed Price) and the third party's fixed price is $40/MWh, the VPPA payment formula will require the Project Company to pay

the C&I customer as if it received $50/MWh, instead of the $40/MWh it actually received, for every MWh sold to the third party. This creates a cash flow concern for the Project Company with respect to where it will receive the $10/MWh shortfall it must pay to the C&I customer, thus creating an uncertainty of payment to the C&I customer.

2. Second, there will also be a mismatch between such third party's creditworthiness versus the wholesale market's creditworthiness. Wholesale markets for electricity (until Texas Winter Storm Uri in 2021) are typically considered very safe. Even after Winter Storm Uri, a third party purchasing physical electricity from the Project Company is probably less likely to pay its bills as compared to the wholesale market. This creates more uncertainty as to the Project Company's ability to pay the C&I customer because the C&I customer must rely on the third party's ability to pay the Project Company for the Project Company to pay the C&I customer.

Some of these credit concerns could be partially mitigated through credit support, but any type of credit support, absent an unlimited parent guaranty, has its limits. Instead, a Project Company will provide a covenant to the C&I customer that the Project Company will not physically sell the electricity it is financially settling with the C&I customer to anyone, except for sales into the wholesale market.

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