GIEK Garantiinstituttet for eksportkreditt

Guarantee scheme for long-term power purchase contracts

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Industrial companies' obligations

The Power Purchase Guarantee Scheme is designed to ensure fulfilment of the obligations which industrial companies make to sellers of electric power or to banks or other lenders that finance power purchases.

Industrial power contracts are generally large and changing power prices can have a major effect on a contract's value. Due to the risk of a power purchaser defaulting, the seller often requires purchasers to provide a bank guarantee ensuring payment for the electricity supply.

Under GIEK's new guarantee scheme, GIEK is able to issue guarantees to both 1) the power seller, protecting it against a power purchaser's failure to fulfil contract terms, and 2) the banks or other lenders financing the power purchase, protecting their claim to repayment of the loans taken out by the purchaser to pay for portions of the electricity supply in advance.

GIEK can issue guarantees for both physical and financial power contracts, with terms between 7 and 25 years.

A guarantee should reasonably reflect the purchaser's current and future levels of power consumption. The power purchaser must therefore document its historical power consumption and explain how much it expects to consume in future.

Users of the guarantee scheme

The guarantee scheme is reserved for companies registered in Norway with activities in the timber, wood products, wood processing, chemical products and metals industrial segments registered under Norwegian Standard Industrial Classification (SIC2007) codes 16, 17, 20 and 24 and in activities that would have been designated by industrial codes 20, 21, 24 and 27 under SIC2002.

The operations must also have annual power consumption of at least 10 GWh and a contracted volume of at least 35 GWh over the period of the contract.

Guarantees may be issued for power purchase by a single enterprise, or by a group of enterprises (consortium). For a purchasing consortium to receive guarantees in support of its power purchases, consortium members must meet the same requirements for business type that individual companies do.

On issuance of a guarantee in connection with a power-purchasing consortium, the actual users of the power will be liable for payment of their respective shares. GIEK will stipulate requirements if necessary for the consortium's opening balance sheet and for the content of the agreement between consortium participants and, if appropriate, with their parent companies.

Power contracts must be concluded with a power seller inside the European Economic Agreement (EEA) area. This includes both power traders and power producers. The seller must have a sales license in Norway or operate in the Nord Pool market.

Guarantee content, relationship to state support regulations

The guarantee scheme must be on ordinary commercial terms and in compliance with the EEA agreement. This means GIEK must take a risk-based approach to issuing guarantees and set guarantee premiums which ensure that the scheme will break even in the long run (as described in separate section below). Guarantees will not be granted to industrial firms or consortia in financial difficulty.

Furthermore, a guarantee must be linked to a specific power contract for a specified maximum amount and for a limited period of time.

At any one time a guarantee may cover a maximum of 80 per cent of the outstanding financial commitment to which the guarantee applies. The financial commitment in this context would be the remaining payments agreed in the power contract and/or outstanding loans issued in connection with advance payment for the power. Which actors are to cover the final 20 per cent are not stipulated. Accordingly, the power seller, bank or other financial institution may cover the final 20 per cent (or more).

Loss cover provided by GIEK may not exceed the agreed guarantee amount or 80 per cent of any loss that occurs. Any settlement obtained through realisation of the power contract or other collateral is to be distributed pro rata between guarantors, lenders and the power seller.

Security for guarantees

The power contract at issue is to be posted as collateral for the guarantee (see section 7-14 of the Act relating to creditor's rights to satisfaction of claims). The individual power contract that is to be the subject of the guarantee must be submitted to GIEK. GIEK may then require changes or additions to the power contract.

In addition, GIEK may require security in other assets belonging to the power purchaser.

GIEK will also assess the power seller's solidity and, if it seems necessary, require parent company guarantees, bank guarantees or similar instruments.

1. Security in the power contract

Pursuant to a Storting decision in December 2010, a provision was inserted into the Act relating to creditor's rights to satisfaction of claims; the provision regulates legal protection of subrogation rights agreed in long-term power contracts involving energy-intensive industries. Under the provision, agreements on subrogation rights in long-term power contracts are given priority over the power purchasers' estate, lower ranked creditors and subsequently created legal rights in the power purchaser's contractual position. The balance remaining after the guarantor's recourse claim (including interest and costs) is covered falls to the power purchaser, its estate or other rightsholders in the power purchaser's contractual position.

A subrogation rights agreement in a long-term power contract must be concluded no later than the signing of the power contract.

2. Other collateral

GIEK may also require collateral in assets other than the power contract. Any of the power purchaser's assets can serve as collateral, including real property, operating equipment, inventory and outstanding receivables. Shares and other securities and financial instruments may also be posted as collateral. A parent company or other party may also be required to provide a guarantee or other form of security.

3. Power seller risk

A guarantee may also involve power seller risk. If a power seller cannot fulfil the contract as agreed, and the power purchaser therefore cannot or will not service the loan, GIEK will have to pay compensation (to the lender). If the seller's inability to deliver is not transitory, GIEK will have no electric power to sell onwards. The power contract would then have no residual value. The same could also apply to direct cover of the power contract (if the contract after subrogation should prove to have positive residual value). GIEK would therefore assess whether to require a bank guarantee or other terms to protect GIEK against a power seller's non-performance of the power contract.

Default and recovery

The guarantee is applicable in cases of bankruptcy, insolvency and non-payment. If a power purchaser defaults on a power contract or if the guarantee conditions/debt terms (covenants) are unfulfilled, a default situation will have arisen. GIEK will review the power contracts and stipulate among other things what shall entail default and the right to terminate the contract.

In case of default the guarantee recipient is obliged to notify GIEK immediately. The guarantee recipient in such a case must follow the instructions GIEK provides with regard to recovery. From the time of default, it will take some time before GIEK makes any pay-out to the power seller or bank/lender. This is described in more detail in the General Terms.

In a default situation GIEK takes on the power purchaser's obligation in accordance with the terms of the guarantee (up to 80 per cent). In a bankruptcy event GIEK is also entitled to report a negative residual value on the power contract as a claim.

A power purchaser's financial commitment to 1) the power seller is determined on the basis of the power contract's residual value. GIEK may have to pay compensation to the power seller if a situation arises in which the purchaser is unable or unwilling to pay. The amount of compensation will depend on the residual value of the power contract.

A power purchaser's financial commitment to 2) the lender is determined on the basis of the bank's residual receivables at time of default. Compensation paid to the bank (redemption of bank loan) may be wholly or partially recovered if the power contract has positive residual value.

The residual value of the power contract is determined by the difference between the future market price and the contracted power price. A market price lower than the contracted power price gives the power contract negative residual value for the purchaser.

To avoid disputes when determining a power contract's residual value (and the compensation amount), and to reduce the chance of rewarding default, GIEK has the following options in a default situation. GIEK will reserve the right in any case to make payments under the guarantee pursuant to the schedule by which the guarantor recipient was supposed to have received payment from the debtor:

1. Resale in the spot market

GIEK will have the opportunity to step into the power contract and require the power seller to market the power in Nord Pool's spot electricity market. GIEK will then compensate or be compensated for the difference between the power price contained in the power contract and the current spot market price.

Guarantees are to come with a specified maximum amount per year. If this limit has been reached GIEK will not provide further compensation to the power seller (or lender). Since the power price may vary throughout the term of the guarantee, the power seller must commit to pay back compensation it has received if the overall difference between the contract and spot prices changes in GIEK's favour.

An overview of the overall difference between the contract and spot prices must therefore be maintained subsequent to a default.

The power seller may have an interest in placing a clause into long-term power contracts to prevent power from being resold, as the resale of power could lead to a change in resource rent tax for the power seller (described below). Such clauses must not bar GIEK from reselling the power in a default situation. If GIEK does choose to resell power in the current spot market, it remains free at a later date to choose to market the power in accordance with points 2 or 3 below.

2. Resale of power contract to another user
GIEK will have the opportunity to resell the power/power contract as a whole to one or more users at a lower power price than that of the original power contract. The power seller would then be compensated according to the amount of power resold and the difference between the original price and the price at which the power is resold.

If GIEK resells the power contract to another user after a default, the new purchaser should represent as little as possible additional risk to the power seller. The power seller in that case would be entitled to require GIEK or another guarantor to issue a guarantee for the new purchaser.

3. Settlement agreement with one-time payment
GIEK and the power seller will have an opportunity to agree on any future price movement and on that basis settle accounts for the guarantee with a one-off payment.

4. Choose not to step into the power contract
GIEK must also be able to choose not to exercise its right to step into the power contract. This could be the case if GIEK's guarantee extends only to redemption of the bank loan, the power contract's residual value is clearly negative, and GIEK has no obligation to the power seller.

Guarantee premiums

GIEK is to maintain a risk-based approach to the issuance of guarantees and determination of guarantee premiums. Guarantee premiums must take risk into account in a way that makes the scheme self-financing in the long term.

GIEK has set up a guarantee premium model to underpin GIEK's pricing of the two guarantee types. GIEK will calculate annual guarantee premium payments, which in the model are computed as a percentage of the outstanding financial commitment the guarantee corresponds to any time. Upon issuance of a new guarantee, GIEK will have calculated guarantee premiums for each year of the guarantee's term.

The parties will then know the premium they must pay in each individual guarantee year. Unless a default occurs, the guarantee premium will not be adjusted during the term of the guarantee. Computation of the guarantee premium is to be based on an updated, long-term power market analysis, an updated credit rating of the power purchaser (and possibly of the power seller as well) and updated default statistics for the applicable rating class.

In some existing power contracts with industrial companies, the contracted power price is tied to highly complex pricing formulas. GIEK is free to agree with the parties on a guarantee amount derived from a simpler pricing structure than is used in the power contract (preferably nominal power prices for each year).

GIEK will not pose consumption-pattern requirements in the contract between the power seller and purchaser. If the consumption pattern deviates from one of fixed volume and full time in service, GIEK may limit its guarantee to reflect the special terms and conditions. A consumption profile with fixed volumes is a prerequisite for using the model to determine guarantee premiums; it also makes it easier to keep track of outstanding liabilities. In the wake of a default GIEK also reserves the right to its own terms for power delivery. For example, an alternative delivery point in the transmission network could be specified.

According to the EFTA Surveillance Authority's (ESA's) guidelines for state aid, guarantee premiums must reflect three factors: (i) capital cost, (ii) coverage of the guarantee scheme's administrative costs and (iii) general credit risk (risk premium).

1. Capital cost
The capital cost is based on an equity share percentage assigned to each individual debtor. This equity share will depend on the power purchaser's credit rating. ESA guidelines provide for an equity capital premium of at least 400 basis points on the equity assigned to guarantee applicants.

2. Covering the guarantee scheme's administrative costs
The costs to GIEK associated with risk assessment of individual guarantee applicants and follow-up of the commitments over time are to be included in administrative costs.

3. General credit risk (risk premium)
If a situation arises in which a purchaser is unable or unwilling to pay, GIEK may have to pay out compensation to a power seller/lender. The compensation amount will depend on to what extent the power contract's residual value is negative. The model assumes GIEK must have the opportunity to realise a long-term power contract's residual value as well as access to whatever assets the power purchaser may possess.

The starting point for calculating the risk premium is the power purchaser's credit rating and associated default probabilities. GIEK's loss in case of a default will depend fundamentally on how the price of power develops during the guarantee term. GIEK has purchased a long-term market analysis which presents a projected path with a probability distribution relative to future power prices. This makes it possible to calculate the loss anticipated for various power contracts in case of default. The guarantee premium model is flexible in reflecting whether GIEK's guarantee is intended to cover the overall contract amount in full or in part. GIEK also has the opportunity to issue guarantees in connection with power contracts in other currencies.

Opportunity to terminate the guarantee

Terminating a guarantee carries with it an obligation by the guarantee recipient to pay a termination fee as stipulated in the guarantee's special terms.