NORTH EAST AND YORKSHIRE NET ZERO HUB

GUIDANCE NOTE FOR GENERATORS CONSIDERING SOLAR PROJECTS

1. Introduction

1.1 This guidance note relates to the:

1.1.1 draft template air space lease (**Lease**) (together with a template notice and template statutory declaration to take the Lease outside the security of tenure protections of the Landlord and Tenant Act 1954 (if required)); and

1.1.2 related draft template power purchase agreement (**PPA**),

made available by the North East and Yorkshire Net Zero Hub (**Hub**) for use by operators (**Generator** or **Tenant**) and site owners (**Owner** or **Landlord**) entering into an arrangement whereby the Owner grants an air space lease to the Generator, who then installs solar panels on the roof and sells the energy generated by the panels to the Owner pursuant to the PPA (and any excess energy to third parties) (a **Project**).

1.2 The template Lease and the PPA, as drafted, envisage the specific arrangement described in paragraph 1.1 above, in which the Owner/Landlord enters into the PPA and the Lease for the use of Energy by the Landlord. If the parties are considering taking an alternative approach, such as the one described in paragraph 4.6 below) or one where, for example, a lease is granted by a site freehold owner to a generator, which then enters into multiple separate PPAs with the freehold owner's tenants, the template Lease and PPA may not be suitable and/or additional agreements may be required. In any alternative scenario, the parties will need to carefully consider the contractual approach and ensure any PPA(s) and/or leases are tailored to the scenario and any additional agreements put in place (such as a PPA between a site owner, as buyer of energy from a generator, and the users of that energy at the site)..

1.3 This guidance note is for the sole use of Generators who qualify for support from the Hub in relation to Projects. It is not for Owners and should not be shared with them.

1.4 This guidance note has been prepared by Muckle LLP. Muckle LLP is not instructed by any Generator or Owner and accepts no liability to any of them including in relation to:

1.4.1 the Lease, PPA and/or this guidance note and the use of or reliance on any of those documents (modified or not) by any Generator or Owner;

1.4.2 the entry into by any Generator or Owner of any agreement(s) for the installation of solar panels and a related supply of energy, including the Lease and/or PPA (modified or not); and

1.4.3 whether the arrangement contemplated by the Lease and PPA is suitable or appropriate for any Generator or Owner.

1.5 **THE LEASE AND PPA, IF ENTERED INTO, WILL CREATE LEGALLY BINDING OBLIGATIONS ON THE PARTIES. EACH GENERATOR AND OWNER SHOULD TAKE INDEPENDENT LEGAL ADVICE ON THE TERMS OF THE LEASE AND PPA BEFORE ENTERING INTO EITHER OF THEM. THIS GUIDANCE NOTE DOES NOT COVER EVERY PROVISION OF THE PPA OR LEASE NOR DESCRIBE EVERY RELATED ISSUE. THE OWNER AND GENERATOR SHOULD EACH READ AND UNDERSTAND THE PPA AND LEASE BEFORE ENTERING INTO EITHER OF THEM.**

1.6 This report summarises the main terms of the following documents and outlines related issues:

1.6.1 the template Lease; and

1.6.2 the template PPA.

1.7 The template Lease and PPA include drafting notes in the text, marked “DN” and a “Draft” watermark. These should be removed from final versions.

2. **Background**

2.1 Arrangements under which an Owner grants a lease of air space to a Generator, who in turn installs solar panels on the leased area and sells the energy generated back to the Owner, are becoming more common. Ownership of the solar panels and other equipment remains with the Generator, although the Owner may have the right to acquire the solar panels from the Generator when the arrangement comes to an end.

2.2 The Generator generally arranges and funds the installation of the solar panels, and recoups that investment, with a return, by selling the generated energy to the Owner, at a rate which is generally lower than the rates available for energy from non-renewable sources supplied through the National Grid. Any excess energy generated by the panels is sold to a third party supplier; the revenue from that can be split between the Owner and the Generator (although the template PPA reserves that revenue to the Generator).

2.3 The rate charged for the energy sold to the Owner may be agreed at the outset and index linked or may be determined on some other basis (as in the template PPA, which includes an option for using a discounted benchmark rate). A Generator may expect a minimum spend commitment from the Owner, as well as the right to receive a buy-out compensation payment in the event of early termination by the Owner (except perhaps where the Owner terminates for the Generator’s default or insolvency or the Generator exercises a no-fault termination right), to put the Generator in the position it would have been in had the supply arrangement run its full term, commonly 20 or 25 years.

3. **Preliminary matters; governance**

3.1 The template Lease and PPA both assume that planning permission and necessary consents for the installation and operation of the Equipment and the related works will have already been obtained or will be in the process of being obtained or dealt with before the Lease and PPA are entered into.

3.2 The template Lease assumes there is no agreement for lease to deal with those kind of preliminary issues: an agreement for lease would commit the parties to entering into an agreed form lease (attached to the agreement for lease) once specified conditions had been met or preliminary matters completed, such as the grant of suitable planning permission. Without an agreement for lease in place beforehand, a party incurring costs for any preliminary work will be doing so at risk where the other party for whatever reason then decides not to proceed.

3.3 If the Lease and PPA are entered into without necessary third party consents or planning permission and those consents or permissions are refused or delayed or inadequate for any reason, a Party may find it is unable to perform its obligations under those agreements or that it will be in breach of other contractual or regulatory obligations if it does so perform.

3.4 The Owner and Generator will need to consider at an early stage any preliminary matters, including the need for planning permission for the installation and operation of the Equipment and (if applicable) the need for any third party consents to the grant of the Lease and the Project generally (including consents from any funder of the Owner or Generator).

3.5 The Generator and Owner will each need to ensure they have considered and complied with their own internal governance requirements in relation to the Project and entry into by them of the Lease and PPA, including where relevant, any applicable to either of them as a local or public authority.

4. **Lease**

4.1 **Parties: guarantor**

4.1.1 The Lease is an agreement between the Owner and the Generator. No other parties acquire any rights or accept any obligations under the Lease, unless a guarantor is included. The signed dated lease will need to be registered at HM Land Registry, if the Contractual Term is 7 years or more and will be a publicly available document.

4.1.2 As drafted, the Lease includes optional wording and a form of third party guarantee in favour of the Landlord for the Generator's obligations as tenant under the Lease. This is a matter for the Owner to raise if it wants that guarantee. The Generator should remove the template guarantee and related provisions before sharing a draft Lease with the Owner if it has been agreed there is to be no guarantee or where the question of a guarantee has not been raised and the Generator does not wish to flag it by inclusion of the guarantee in the draft Lease.

4.1.3 Where the Tenant is a company include its full corporate name and registered number in the details for the tenant at page 4, and if it is some other entity include its full name and registration details and if a local authority or similar the full name of the authority in such form as may be required.

4.2 **Rent, SDLT**

4.2.1 As drafted, the Lease requires the Tenant to pay an annual peppercorn rent, together with any interest and other sums due under the Lease, and any applicable VAT. See clause 2.2.

4.2.2 The Lease is granted for a peppercorn rent and there is no premium payable in respect of the Lease. On that basis there should not be any SDLT payable on the grant of the Lease but the parties should take appropriate legal and tax advice before entering into the Lease.

4.3 **Rateable value**

Regarding the prohibition on the Tenant from making any proposal to alter the rateable value (at clause 8.2 in the Lease), there is currently a policy for solar panels not to impact the rateable value of commercial property but this policy may change due to changes in policy/ legislation. This provision will need to be reviewed at entry into the Lease in line with the circumstances at the time.

4.4 **Dealing with the Equipment at the end of the Term**

Clause 20 of the Lease states that the Equipment will remain at the Property at the end of the term of the Lease unless the Landlord notifies the Tenant that it (the Tenant) must remove the Equipment at the end of the term. Various other scenarios could be agreed, in which case the wording would need to be amended to reflect the agreed position. Most obviously the parties may agree:

4.4.1 the Equipment will in any event be removed and taken away by the Tenant at the end of the Term and the roof made good;

4.4.2 the Landlord retain the Equipment and pay to the Tenant market value for the Equipment according to the market value of the Equipment assessed at the time.

4.5 **Contractual Term**

4.5.1 The contractual term of the Lease is stated as 26 years. This is on the basis the Commencement Date Longstop in the PPA is set at the date 12 months from the date of the PPA. If the Generator fails to get the Equipment Operational by the Commencement Date Longstop, the PPA automatically terminates and so does the Lease. However, assuming the Equipment is Operational within the first year of the PPA, the Lease needs to continue from that date for the 25 year Supply period which begins on the Commencement Date. The Commencement Date could fall at any time up to and including the Commencement Date Longstop, so the Lease term needs to allow for that, as well for the period before the Supply begins (the period between the PPA Agreement Date and the Commencement Date, in which installation etc by the Tenant can occur), hence 26 years.

4.5.2 The PPA will end at the end of the Supply period (or sooner if terminated earlier for breach or insolvency, say), and as drafted, the Lease will end at the same time as the PPA, so the Lease may therefore end before the 26 years are up.

4.5.3 The Lease is drafted on the basis the Tenant will not have the security of tenure protections for business tenants under the Landlord and Tenant Act 1954 (**1954 Act**).

Documentation to give effect to the exclusion of those protections will be required to be completed before the Lease is entered into. The Landlord must issue a 1954 Act Landlord's warning notice to the Tenant, in the required form, prior to entering into the Lease, which excludes the Lease from the security of tenure provisions under the 1954 Act. The Tenant must then swear a statutory declaration, in the required form and in accordance with the relevant formalities. A template warning notice and template form of statutory declaration are provided with this guidance note.

4.6 **Landlord with a sub-tenant**

4.6.1 The Owner will need to be a party to the Lease and the PPA. The Generator should not enter into a Lease with one entity and a PPA with another.

4.6.2 If there is a sub-tenant or other occupier of the building who will benefit from the Supply under the PPA, the Owner (as Landlord) may need to consider putting in place a back to back PPA between the Landlord and the building occupier on the same or similar terms to the PPA between the Landlord and the Generator or other contractual protection to ensure the cost of the Energy consumed is paid by the sub-tenant to the Landlord, if required, and otherwise ensure the sub-tenant complies with the provisions of the PPA.

4.6.3 This would need to be considered in more detail at the time and specific legal advice would need to be taken by the Parties. The Owner under the PPA would still have the obligation to pay the Generator for the Supply, even if a sub-tenant is using the Energy.

4.7 **Building insurance**

The Lease contains a provision at paragraph 3.1 of Schedule 6 which states that any increase in the Landlord's building insurance as a result of the Project will be paid for by the Tenant. This provision should be considered carefully by the Tenant before entry into of the Lease.

4.8 **Termination/Forfeiture**

4.8.1 Clause 52 deals with termination of the Lease.

4.8.2 As drafted, the Lease automatically terminates in the event the PPA is terminated.

4.8.3 The clause also sets out the circumstances in which compensation is payable by the Landlord to the Tenant for early termination. The Tenant should consider this clause carefully and the triggers for payment of compensation. For example, if the Landlord terminates for the Tenant's default or insolvency, should that give rise to the compensation payment to the Tenant? Equally, if the Tenant exercised a break right under the Lease (if there was one) or exercised a no-fault termination right under the PPA (if there was one) should that give rise to an entitlement for the Tenant to receive the compensation payment?

4.8.4 Clause 48 of the Lease deals with forfeiture. The Landlord may re-enter the Property if the rent is unpaid for 21 days, if there is any breach of any tenant covenant in the Lease or if the Tenant enters insolvency etc. Depending on the circumstances, the Tenant may be entitled to relief from forfeiture.

4.9 **Removal of Equipment for the purposes of repair**

4.9.1 There is an optional clause 18 in the Lease which states that in the event that the Landlord needs to carry out significant roof repair works which requires removal of the Equipment, the Landlord can require the Tenant to do so (but not more than a set amount of times during the term of the Lease), if this is something the parties wish to include.

4.9.2 Include the Landlord's reservation at Schedule 3, paragraph 1.9 if the optional clause referred to in paragraph 4.9.1 above is included.

4.9.3 If clause 18 is not used, the parties will need to ensure the clause references in the Lease are updated accordingly.

5. **Power purchase agreement or PPA**

5.1 The PPA creates an obligation on the Generator to operate the Equipment and supply the electricity to the Owner at the Property, and a corresponding obligation on the Owner to take the electricity and pay the agreed price.

5.2 The PPA has been designed so that the parties can complete the details on the cover sheet (headed and referred to as the **Contract Details**), which will then work with the terms and conditions (headed and referred to as the **PPA Terms**) that sit behind that cover sheet.

5.3 However, before it is shared with a prospective Owner, the PPA will need to be reviewed and tailored for use by the particular Generator and then for use in any particular case. For example, the Generator may decide it will only ever offer a specified rate per kWh subject to a CPI increase, in which the relevant wording for that should be selected in the Contract Details

(Option 1) and the wording for the alternative Option 2 pricing (discounted benchmark) removed, in order to create a standard form for that Generator. Of course, a Generator may also wish to make other changes to the template so that it fits with that Generator's circumstances and offer.

5.4 Once tailored to reflect the Generator's standard offer, the PPA will then need to be shared with the proposed Owner and deal specific details added to the Contract Details, such as the Agreed Term, Base Unit Price, Payment Period etc. Of course an Owner may wish to negotiate the Contract Details and PPA Terms. The Generator should consider issuing and agreeing a non-binding offer (aka heads of terms etc) with an Owner before issuing the PPA and Lease, just to ensure the headline terms – overall structure/approach, duration, key dates, rates and basis of charging etc – are agreed.

5.5 The Terms should not be separated from the cover sheet. Together they form the PPA. The Contract Details and PPA Terms are the entirety of the PPA. The PPA, in template form, does not include or incorporate any other document(s). Clearly the Lease must be used with the PPA but the Lease is a separate agreement. It does not form part of the PPA.

5.6 **Parties; guarantor**

5.6.1 The PPA is an agreement between the Owner and the Generator. No other parties acquire any rights or accept any obligations under the PPA.

5.6.2 As drafted, the Owner's obligations under the PPA are not guaranteed by any third party, such as a shareholder or parent company or other group company. The Generator should ensure it is comfortable with the Owner's financial covenant strength and that the Owner will be able to meet its obligations under the PPA, which are in essence its obligations to pay the price for electricity supplied. (Similarly, the Generator's obligations are not guaranteed by any third party.)

5.6.3 Where the Generator is a company include its full corporate name and registered number in the Contract Details, and if it is some other entity include its full name and registration details and if a local authority or similar the full name of the authority in such form as may be required.

5.7 **Duration and termination**

5.7.1 The PPA takes effect from its date (defined as the Agreement Date) and runs from that date until the date which falls at the end of a specified period – as the parties may agree but commonly 20 or 25 years – beginning from the date the Equipment has been installed and commissioned and is Operational (defined as the **Commencement Date**).

5.7.2 If the Equipment has not been installed and commissioned by the Commencement Date Longstop – the date will need to be agreed and added to the Contract Details – the PPA automatically terminates. Inclusion of a Commencement Date Longstop ensures there is a deadline for installation and an exit route for the parties if the installation has not happened by then, and is arguably more for the benefit of the Owner than for the Generator. Without the Commencement Date Longstop and related automatic termination wording, the installation and commissioning period could continue indefinitely (depending of course on what other termination rights might be available to a party).

5.7.3 The PPA will usually include early termination provisions, which are available to a party where the other party commits a material breach of the PPA terms, or enters into an insolvency process, or (sometimes) undergoes a change of control (as where the shares in an Owner are acquired by a new controlling shareholder). A Generator would want to be able to terminate early for an Owner's material breach or insolvency. The parties may also agree to early termination for convenience, on an agreed period of notice, possibly subject to a minimum period. Clearly a Generator might prefer an Owner not to have such a right, unless its exercise triggered a suitable buy-out compensation payment to the Generator.

5.7.4 The PPA is stated to automatically terminate if the Lease terminates. This provision should not be deleted. An equivalent provision is included in the Lease, so that the Lease comes to an end if the PPA is terminated.

5.8 **Price**

5.8.1 The template PPA allows for two different pricing models. The required or agreed option should be selected and redundant alternative clauses removed, before the PPA is shared with the Owner. Of course the Parties are free to agree other pricing models, in which case appropriate amendments will be required to reflect those.

5.8.2 The simpler option in the template PPA is a fixed rate per kWh, subject to an annual inflationary increase. The PPA allows for an increase by reference to the annual increase in the Inflationary Rate, which can be specified in the Contract Details as the UK CPI or UK RPI.

5.8.3 The more complex option in the template PPA involves applying a discounted benchmark rate, subject to a minimum specified rate (the Minimum Rate). The benchmark rate is either an average of the rate(s) the Owner has paid other energy suppliers over a test or reference period or an industry average as prepared by the UK government – see Gas and electricity prices in the non-domestic sector - GOV.UK. If the discounted benchmark rate is chosen, make sure one of the two mechanisms for determining that benchmark is selected and the other deleted: see the definition of Benchmark Rate in the Contract Details. An agreed percentage discount (the **Discount Rate**) is then applied to that benchmark rate to determine the rate payable under the PPA for electricity supplied during that test or reference period. The test or reference period in the PPA is a Billing Period, defined as a calendar Quarter (ie a three month period), beginning on a Quarter Date, with allowance for a Commencement Date or Expiry Date which falls partway through a Quarter.

5.8.4 All sums stated are stated exclusive of VAT, payable in addition.

5.9 **Invoicing and payment**

5.9.1 The PPA allows for quarterly billing in arrears.

5.9.2 The PPA Terms, at clause 6.2, state the period within which the Generator must issue an invoice. The period should be added before the PPA Terms are issued. Invoices must be paid by the Owner within a specified period. The period should be added to the Contract Details, at the definition of Payment Period.

5.9.3 Save for invoiced sums under dispute, interest accrues on overdue sums in accordance with clause 6.5 in the PPA Terms, at the annual rate of 4% over the Bank of England base rate (and 4% if the base rate is ever zero or less). That rate is reasonable.

5.10 **Minimum spend, minimum output**

5.10.1 The PPA includes wording to impose a minimum annual spend obligation on the Owner, regardless of how much electricity from the Equipment is used. Clearly this will protect the Generator's investment but an Owner may object or negotiate the minimum spend downwards. The relevant metrics should be added to the cover sheet. If consumption is less than the minimum spend requirement and the Generator exports all or part of the unused electricity to another off-taker (the **Shortfall**), the export revenue received is applied to reduce the minimum spend obligation on the Owner

5.10.2 Remove the relevant clauses dealing with a minimum spend if a minimum spend obligation is not agreed or required.

5.10.3 Reasonably enough for the supply of energy from solar panels, the PPA Terms include a statement (at clause 5.5) that the Generator does not guarantee the electricity output from the Equipment. This provision should not be deleted.

5.11 **Excess electricity**

Any excess electricity not used by the Owner is sold to a third party supplier and any revenue from that sale is kept by the Generator. If that revenue is to be shared with the Owner, appropriate amendments should be made to the PPA.

5.12 **Assignment**

5.12.1 There are restrictions on the Owner preventing it from transferring the benefit of the PPA to a third party without the Generator's consent. An Owner may want some exceptions to that restriction where, for example, the Owner sells the reversion to the Lease. In that scenario, the Owner may wish to transfer the benefit of the PPA to the new owner of the reversionary interest, but if it does so, it needs to be on the condition that the new owner enters into a direct contractual commitment to the Generator to comply with the PPA.

5.12.2 A Generator may require the new owner's obligations to be guaranteed by a third party, within the new owner's group, or possibly by the outgoing Owner, which could seek a counter-indemnity from the new owner.

5.13 **Liability caps and exclusions**

5.13.1 The Generator should consider the liability caps and exclusions at clause 13 of the PPA.

5.13.2 The PPA excludes each party's liability for certain categories of loss, such as loss of profit, loss of revenue (other than revenue under the PPA), loss of goodwill, and so on. Arguably the Generator might prefer not to exclude the Owner's liability for those categories of loss.

5.13.3 Most losses for a breach of contract are "direct", meaning they are losses which naturally flow from the breach. Indirect (or consequential) losses are particular matter specific losses that were flagged by a party pre-contract as a possibility, so are less common. However, an exclusion of that type of loss is common unless of course there are particular losses or scenarios that the parties wish to cover and which might constitute indirect losses.

5.13.4 Some liabilities cannot be capped or excluded. Those are liability for death or personal injury caused by a party's negligence, liability for fraud, and liability under some of the implied terms under the Sale of Goods Act 1979 or Supply of Goods and Services Act 1982.

5.14 **Insurance**

The Generator should take advice from its insurance brokers on the nature and level of any insurance for the Project. If the Generator requires the Owner to carry any particular insurance, an obligation on the Owner to do so should be added to the PPA. The Lease may also include insurance obligations on the parties.

5.15 **Direct agreement and step-in for funder**

5.15.1 Where the Generator is using a bank or other third party funder to fund the Project, the funder may want to see protections for the funder in the PPA. It is for the funder to decide and add whatever provisions it may require.

5.15.2 Most obviously these would include step-in rights for the funder, so that it can take over the management and operation of the Equipment and supply where necessary to protect its investment, and a requirement on the Owner to enter into a direct agreement with the funder agreeing to comply with the PPA, so the funder has direct contractual rights against the Owner.

5.16 **Consequences of termination**

5.16.1 The Owner must immediately pay any unpaid charges for the Supply.

5.16.2 The Lease includes a provision dealing with what happens to the Equipment at the expiry or termination of the Lease (which will always match the expiry or termination date of the PPA), as well as any compensation payment due to the Generator from the Owner on early termination.

5.17 **FOIA etc**

The PPA includes a brief clause dealing with Freedom of Information Act 2000 compliance, which may be appropriate to include for public sector Generators. Where the Generator is a public sector entity, the Generator should consider whether any other contractual provisions are required as a result of that status.

5.18 **Dispute resolution**

Clause 26 sets out an escalating dispute resolution procedure, which goes to expert determination. Consider alternatively a reference to mediation or arbitration and amend accordingly if that is required.

Muckle LLP
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