Take-or-Pay & Take-and-Pay

Practical and Bankability Considerations in Power Purchase Agreements

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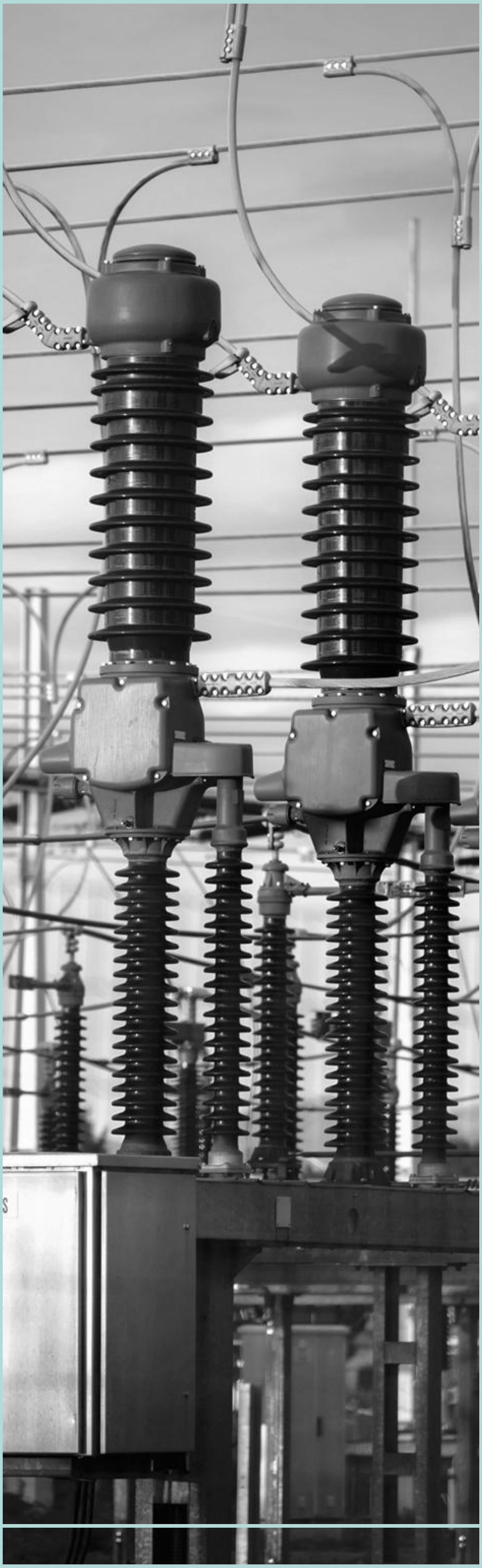
Over the years, power markets worldwide have relied on contractual frameworks to allocate risks, ensure revenue certainty, and facilitate investment in capital-intensive infrastructure. In Nigeria, the electricity sector has long grappled with structural inefficiencies, including inadequate generation and transmission capacity, liquidity shortfalls, and tariff gaps.

Power Purchase Agreements (PPAs) have consistently served as the cornerstone of investments in the sector, typically structured around two well-established contractual mechanisms: Take-and-Pay and Take-or-Pay obligations. Under any PPA, energy or gas sale agreement, the producer (Generator) undertakes to make a specified volume of power, gas, or energy available to the purchaser.

The purchaser's obligation to pay then depends on the agreed contractual structure, which determines whether payment is contingent on actual offtake (Take-and-Pay) or guaranteed irrespective of offtake (Take-or-Pay).



Understanding Take-and-Pay

Take-and-pay PPAs shift risk:

buyers save upfront, but GenCos lose revenue certainty.

Unpredictable cash flows under take-and-pay have long hindered financing for Nigeria's IPPs.

In a PPA, a take-and-pay arrangement refers to a structure where the purchaser pays only for the electricity actually delivered and consumed, regardless of the producer's contracted capacity or generation availability. The purchaser's payment obligation is therefore limited to the volume of power taken.

Historically in Nigeria, the Nigerian Bulk Electricity Trader (NBET), acting as the central bulk buyer, entered into PPAs with Generating Companies (GenCos) and resold power to Distribution Companies (DisCos). Most of these PPAs were structured on a take-and-pay basis, under which DisCos were only required to pay only for the electricity actually delivered to them.

While this model offers operational flexibility and reduces immediate financial exposure for buyers, it offers limited revenue certainty for generation companies, and therefore has more appeal for projects with intermittent renewables such as solar PV, wind, run-of-river hydro, where output follows resource availability and dispatchability is limited. The absence of predictable cash flows undertake-and-pay arrangements has long constrained the ability of Independent Power Producers (IPPs) to attract long-term project financing. In effect, while take-and-pay mitigates immediate payment obligations for buyers, it exposes suppliers and lenders to demand and dispatch risk, a major concern in markets such as Nigeria, where off-taker liquidity challenges persist.

Understanding Take-or-Pay

Take-or-pay contracts provide GenCos with predictable revenue, a key factor in financing power projects.

NERC's July 2024 reform introduced bilateral trading, leading to wider use of take-or-pay PPAs.

By contrast, under a take-or-pay arrangement, the purchaser agrees to either purchase a minimum contracted volume of electricity or if the purchaser opts not to offtake the agreed minimum contracted volume, to pay in full for the agreed minimum contracted volume of electricity.

The introduction of the NERC Order on the Transition to Bilateral Trading in Nigeria in July 2024 phased out NBET's role as the single bulk electricity trader. GenCos and DisCos now negotiate directly under bilateral agreements, with NBET retaining only a limited role in administering a few legacy firm contracts and managing an interim pool of residual capacity. As a result, this bilateral trading has witnessed the adoption of the take-or-pay arrangement in recent PPAs.

Take-or-pay contracts provide predictable revenue streams for GenCos, which is a critical factor for securing debt financing for capital-intensive projects like thermal power plants and renewable energy IPPs. They also underpin Gas Sale Agreements (GSAs), where suppliers require certainty before committing to long-term fuel supply and infrastructure investment.

However, the model comes with trade-offs. In the Nigerian context, take-or-pay can strain purchasers' finances if tariffs are not cost-reflective or if operational inefficiencies constrain electricity consumption. Off-takers must carefully manage contractual obligations to avoid liquidity stress while ensuring that capacity payments support continued generation and system reliability.

The choice between take-or-pay and take-and-pay ultimately comes down to a trade-off between revenue certainty and operational flexibility.

Comparative Analysis of Take-and-Pay and Take-or-Pay

1. Revenue Certainty vs Operational Flexibility

Take-or-pay structures prioritize revenue certainty for GenCos. By obligating DisCos to pay for contracted capacity or energy regardless of actual offtake, these clauses underpin the predictable cash flows that lenders and investors require. This structure effectively insulates GenCos from market volatility, demand fluctuations, and collection inefficiencies in the downstream sector. The result is a bankable framework that facilitates long-term financing, reduces risk premiums, and enhances the credit profile of the project.

On the other hand, Take-and-pay provisions emphasize operational flexibility for DisCos. Payments are only triggered when power is physically delivered and consumed, aligning contractual obligations with actual demand. This is particularly relevant in markets where DisCos face weak billing and collection systems, high aggregate technical and commercial losses, or unpredictable consumer demand patterns. From the DisCo perspective, take-and-pay mitigates the risk of paying for unused energy and prevents the accumulation of stranded costs.

However, this flexibility comes at a cost to bankability. Because revenues under take-and-pay are directly linked to actual dispatch and end-user collections, GenCos face heightened volume risk and credit risk. Financing such projects typically requires higher equity contributions, government guarantees, or risk-sharing mechanisms to compensate for the lack of assured revenues.

In essence, the tension lies between certainty of revenues for GenCos and flexibility of obligations for DisCos. While take-or-pay ensures financial stability and investment viability, take-and-pay accommodates operational realities but can undermine the financial robustness needed for project development and long-term debt sustainability.

2. Fiscal Exposure and Risk Allocation

Under take-or-pay structures, fiscal exposure is largely borne by the party assuming the payment obligation. Historically, when NBET served as intermediary between the GenCos and DisCos, take-or-pay commitments effectively transferred the payment risk to the Federal Government. This arrangement guaranteed return of revenue to GenCos and their financiers, irrespective of the performance or liquidity constraints of downstream DisCos. While this enhanced bankability, it also concentrated significant fiscal risk on the Federal Government, contributing to the accumulation of government-backed payment obligations.

With the transition toward bilateral contracting frameworks, the risk allocation has shifted. DisCos now bear take-or-pay obligations directly, requiring them to exercise greater discipline in matching contracted capacity with realistic demand forecasts, collections efficiency, and loss reduction strategies. This structure places the onus on DisCos to prudently manage both operational and financial risk, while simultaneously exposing GenCos to the creditworthiness and operational competence of their offtakers.

By contrast, take-and-pay structures allocate less fiscal exposure to DisCos upfront, since payments are tied to actual offtake. While this limits the build-up of unsustainable fixed payment liabilities, it transfers greater volume and dispatch risk back to GenCos. For lenders, this creates heightened uncertainty, as the GenCo's revenue stream becomes dependent on the performance of entities that are themselves struggling with structural inefficiencies.

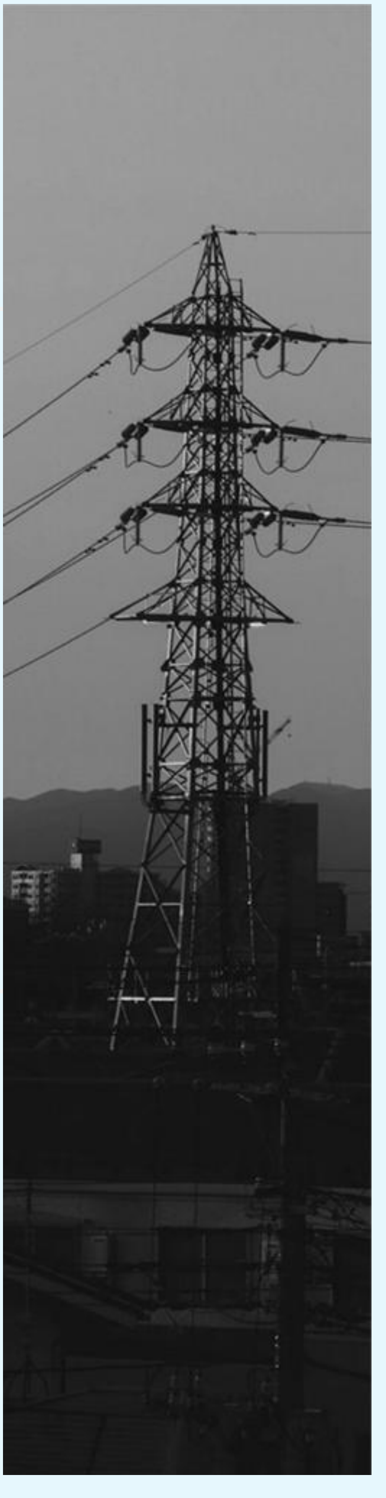
3. Bankability Considerations

From the lender and GenCo perspective, take-or-pay structures are clearly advantageous. They stabilize projected revenues, ensure consistent debt service coverage, and make projects more attractive to both debt and equity investors. For projects with high upfront capital costs and long payback periods, this security is indispensable; without it, financing would either be prohibitively expensive or unavailable altogether. In this sense, take-or-pay is the mechanism that makes large-scale generation projects possible in emerging markets with elevated credit risk.

On the other hand, from the DisCo perspective, take-and-pay can be equally rational. DisCos operate closest to the consumer and therefore absorb the impact of poor collections, technical losses, and fluctuating demand. Forcing them into rigid take-or-pay commitments may generate unsustainable liabilities, weaken their balance sheets, and ultimately destabilize the sector. By paying only for energy that is actually dispatched and consumed, take-and-pay allows DisCos to better align financial obligations with operational realities, protecting them from insolvency risks and, by extension, reducing the likelihood of systemic bailouts.

Both positions are legitimate: GenCos require payment certainty to secure financing, while DisCos require contractual flexibility to manage commercial and operational volatility.

Finding the Balance: Practical Considerations in Negotiation



Negotiating take-or-pay and take-and-pay provisions is less about the legal drafting of clauses and more about the allocation of commercial risk acceptable to each party. The outcome is shaped by the bargaining strength of GenCos, DisCos, lenders, and, in some cases, the government as guarantor. The following are key consideration points:

1. Demand Forecasting and Load Growth:

DisCos are reluctant to commit to rigid take-or-pay obligations where electricity demand growth is uncertain, or distribution infrastructure remains inadequate. Overcommitting to capacity in such conditions exposes them to significant financial risk. By contrast, GenCos and their lenders press for firm minimum payment commitments to shield revenues from the consequences of inaccurate demand projections. As a result, negotiations often hinge on the credibility of demand studies and the transparency of assumptions behind projected load growth.

2. Curtailment and Dispatch Risk:

A recurring issue is whether GenCos should still be paid under take-or-pay if the grid operator curtails generation for technical or system-stability reasons. GenCos will argue that curtailment is outside their control and should not affect revenue; DisCos will argue against paying for undelivered energy. Negotiations here often determine the viability of the financing mode.

3. Creditworthiness and Payment Security:

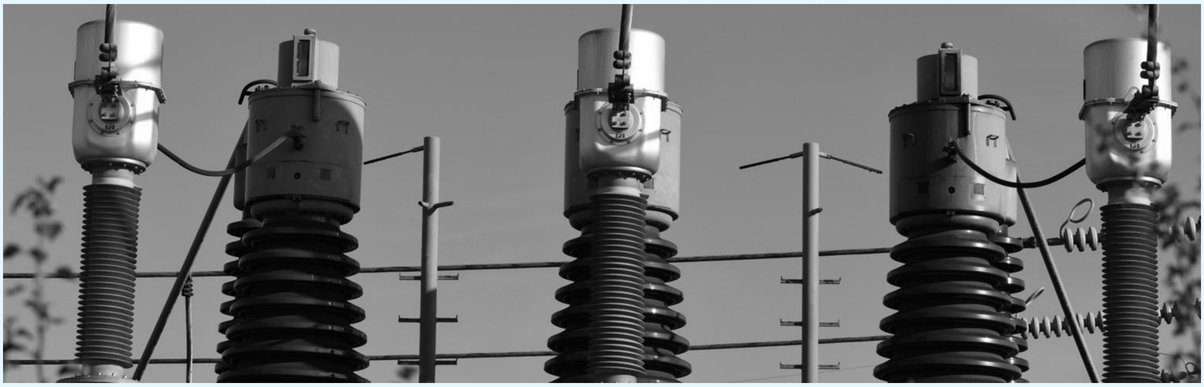
The financial standing of DisCos is another crucial consideration. From the GenCo and lender perspective, weak balance sheets heighten payment risk, leading them to demand additional security instruments such as sovereign guarantees, escrow accounts, or standby letters of credit to support take-or-pay obligations. DisCos, on the other hand, are wary of assuming rigid commitments without reliable revenue inflows, and in such circumstances tend to favor take-and-pay structures unless sufficient credit enhancement is provided. The negotiation, therefore, hinges on how payment security is structured and by whom it is underwritten.

4. Termination and Buy-out Rights:

Termination provisions are particularly sensitive. Lenders require termination payments that are sufficient to cover outstanding debt in the event of early contract termination, as this guarantees repayment irrespective of political or market events. DisCos counter that unlimited or punitive termination liabilities are unsustainable and may themselves destabilize the sector. They often push for caps, phased reductions, or conditions under which termination obligations are mitigated. The negotiation of these provisions tests how far each party is willing to stretch in order to protect their long-term financial position.

5. Hybrid and Compromise Structures:

Because the interests of GenCos, DisCos, and lenders rarely align perfectly, negotiations often resolve in hybrid payment frameworks that attempt to balance certainty with flexibility. These models are designed to preserve the minimum revenue stability required for bankability while giving offtakers enough operational leeway to avoid unsustainable financial exposure. Some of these models include:



a. Minimum Offtake Commitment:

Under this approach, a baseline take-or-pay obligation is established at a level sufficient to cover debt service and fixed operating costs. Any generation above this threshold is then treated on a take-and-pay basis, allowing DisCos to match payments more closely with actual demand(and allowing GenCos source for alternative off-takers ahead of time, where applicable). This creates a financial floor for GenCos while preventing DisCos from paying for large volumes of unused capacity.

b. Capacity Plus Energy Split:

Under this approach, capacity charges are structured on a take-or-pay basis, ensuring that fixed costs and financing obligations are consistently met, while energy charges are paid only for power actually dispatched. This mirrors arrangements in many international PPAs and reflects a natural division between fixed and variable cost recovery.

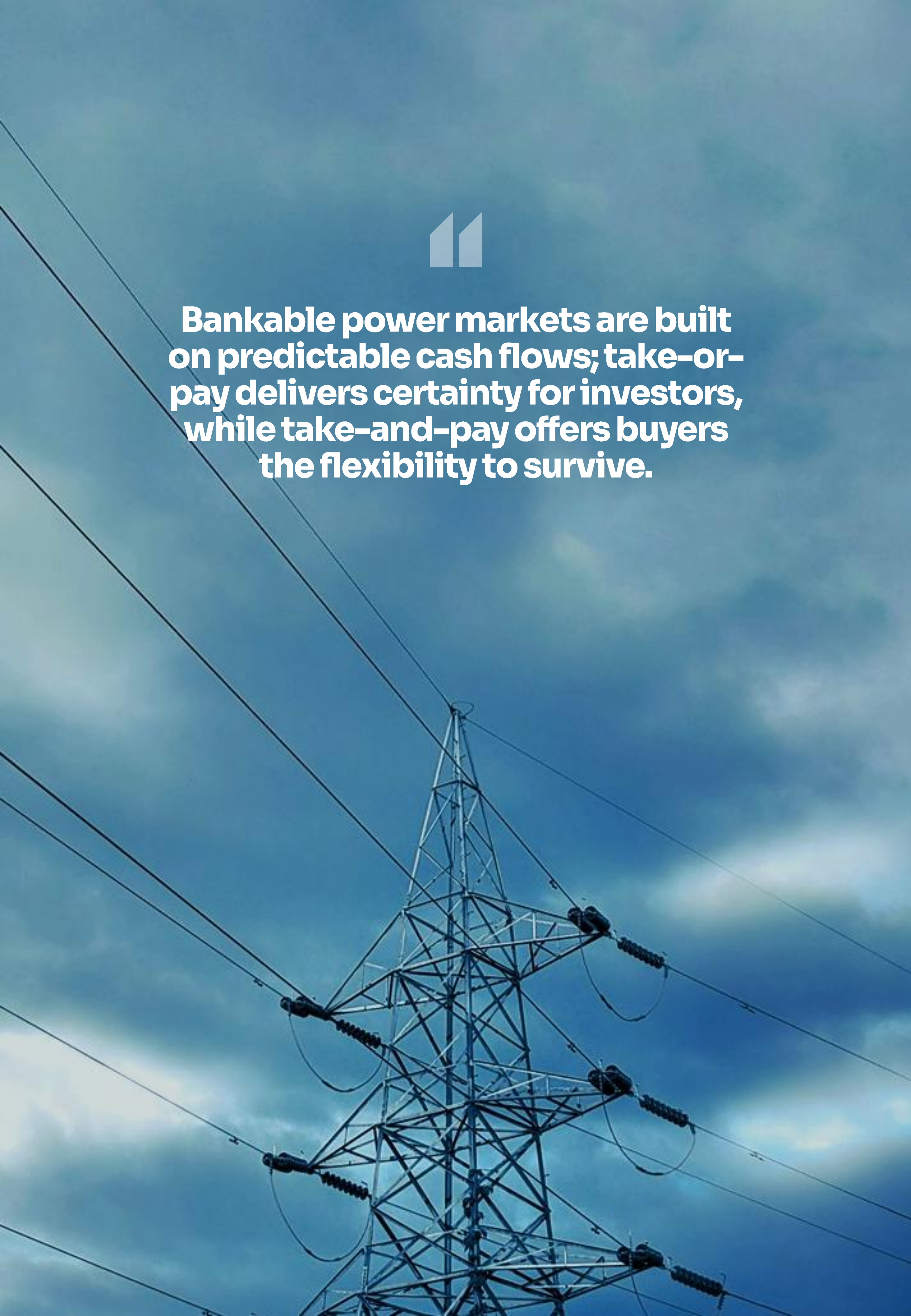
c. Ramp-Up or Phased Take-or-Pay Obligations:

This is where the offtaker's minimum payment commitments increase gradually over time in line with expected demand growth. This mechanism gives DisCos breathing room in the early years of a project, while still assuring lenders that revenues will strengthen as the market matures.

d. Curtailment-Adjusted Take-or-Pay:

Under this model, GenCos retain payment rights even if generation is curtailed for reasons beyond their control, but DisCos are shielded where curtailment results from GenCo fault or contractual non-performance. This allocation recognizes operational realities without undermining the GenCo's ability to service debt.

While no hybrid model eliminates all risk, these structures reflect a pragmatic recognition that the Nigeria power sector requires contracts that are both bankable for investors and sustainable for offtakers.



> Bankable power markets are built on predictable cash flows; take-or-pay delivers certainty for investors, while take-and-pay offers buyers the flexibility to survive.

Conclusion

Take-or-pay and take-and-pay arrangements are not mutually exclusive; rather, they are complementary tools for balancing investment bankability with operational and fiscal discipline. In Nigeria, the transition from centralized NBET-managed contracts to bilateral agreements has shifted the dynamics of risk and responsibility. While take-or-pay ensures revenue certainty for generators and lenders, take-and-pay preserves flexibility for buyers in a challenging market. The challenge and opportunity lies in structuring PPAs that judiciously combine these approaches, enabling sustainable investment, reliable electricity supply, and financial stability across the sector. For Nigeria's electricity market to mature, stakeholders must adopt innovative contractual solutions that reflect practical realities, financial viability, and equitable risk-sharing principles.

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