TECH FOR NET ZERO

Offtake Agreements

An introduction to the instrument and its potential for climate tech startups

Powered by dena Deutsche Energie-Agentur 1.5° Ventures Climate Tech Venture Builder

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Brief summary

*An offtake agreement is a **contractual arrangement** between a **producer** and a **buyer**, where the buyer agrees to purchase a **specified portion** of the producer's **future production**.*

Purpose
It secures a guaranteed market for a portion of the producer's future output, often before the production facility is fully operational.

Importance in financing
It may prove critical for securing the financing of capital-intensive projects, as it provides future revenue certainty to both lenders and investors.

Types of agreements
- **Fixed quantity**: Buyer commits to purchasing a fixed amount of product at pre-agreed intervals.
- **Take-or-pay**: Buyer pays for the product whether they take delivery or not, securing producer revenue.
- **Tolling**: The buyer provides raw materials and receives the final product, involving them more closely in the production process.

Implementation in verticals

Renewable energy
(e.g., solar, wind, bioenergy)
Facilitates financing by securing a buyer for energy outputs, reducing market risk and stabilizing revenue, which attracts more investors.

Sustainable agriculture
(e.g., organic farming, aquaculture)
Guarantees market access and price stability, crucial for operations with significant initial investments, and aids in smoother supply chain integration

Carbon Capture and Storage (CCS)
Provides guaranteed demand for captured carbon, facilitating compliance with environmental regulations and supporting technological advancement.

Green manufacturing
(e.g., sustainable materials or chemicals)
Ensures demand for innovative products, stabilizes operations through long-term contracts, and enhances market credibility.

Waste management and recycling
Secures a market for products from recycled materials or energy, providing financial stability and promoting sustainable waste management practices.

Key elements I

Price

Agreed sales price or **minimum sales price** (depending on structure)

- Sales price can either be pre-agreed or structured as cost pass through in case of tolling agreement

In case of pre-agreed sales price

- Fixed or minimum plus upside sharing
- In case of upside sharing, sharing ratio of upside from minimum price to pre-defined “market price”
- Potential inflation linkage

In case of tolling agreement

- Definition of fixed costs (mostly depreciation of capex), variable cost pass-through (esp. linked to power purchase prices, grid fees, inflation), financing costs and equity return component
- Agreement how future subsidies received by seller or buyer, if any, are shared (at all)

Quantity

- **Fixed quantities** vs. **range**
- **Take or pay**: Buyer typically has the right not to take off the product but then needs to hold the seller harmless, e.g., pay the agreed price and potential additional storage costs or compensate seller if seller has to sell at lower price (e.g., as sufficient storage capacity is no longer available)

Warranty

- Product specification (e.g., min GHG reduction)
- Regulatory confirmations (e.g., RED)
- Production capacity of facility
- Facility availability (% of production capacity)
- Including concrete measurements in each case
- Caps, limitations etc (ideally mirrored by EPC contract)

Key elements II

Conditionalities

- In case of “more binding” MoUs, list of specific conditions precedent which lead to the MoU becoming binding, e.g., approvals, financing, FID etc. with certain timelines

Facility construction and operations

- Seller has operational control over facility
- Involvement of buyer depending on overall structure, (much) closer in case of tolling-style agreement or more at arms lengths
- Agreement which information is shared, whether coordination committees are established etc during construction
- Agreement on reporting obligations during operations

Term

- Targeted COD, latest COD / long-stop date, first commercial delivery date, buyer remedies in case of failure
- Duration of offtake
- Potential extension of initial term (1-3 years before end of initial term), e.g., Rofo, ROFR, good faith negotiation of adjusted terms reflecting cost basis, financing terms, market terms at that point in time

Other

- Potentially most favoured nation clause for (initial / cornerstone) offtaker
- Minimum credit rating of buyer (e.g., investment grade) or credit support
- Changes in taxes, regulation or law
- Force majeure
- Dispute regime: typically international arbitration

Structure

Decision criteria

Tolling agreement vs. fixed price/volume offtake
- Tolling agreement: Suitable when the offtaker desires close involvement, typically providing input or resources, reducing the project's consolidation risk
- Fixed price/volume offtake: Preferred when operational risks remain with the seller, offering predictable revenue streams

Duration and flexibility
- Minimum term: Typically 10+ years to ensure long-term stability and return on investment
- Extension options: Shorter terms may include one-sided extension options that do not support the seller, emphasizing buyer flexibility

Risk management
- Volume and price risks: Early avoidance of market risks through fixed volumes and prices, minimizing renegotiation needs
- Cross-commodity risks: Strategies to mitigate risks between market variables like electricity prices and offtake product prices

Detailed elements

Pricing and payment terms
- Fixed vs. range pricing: Can be structured based on preferences, market conditions, and risk appetite
- Inflation protection: Align long-term contracts with inflation adjustments to safeguard against cost escalations

Contractual obligations and guarantees
- Warranty framework: Ensure back-to-back coverage with EPC contracts to protect against non-performance risks
- Performance obligations: Buyer might have rights not to take off the product; however, must compensate the seller for market sales at potentially lower prices

Investor considerations
- Equity and debt requirements: Ensure covering of debt financing costs and repayments, aligning the structure to minimize equity risk
- Return on investment: The structure should cater to achieving a base case equity return, balancing between risk and reward

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Thank you for your attention.

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