CAN CORPORATE PPAS HELP FACILITATE THE "GREEN RECOVERY"?

As lockdown eases and the UK emerges from the most damaging effects of the COVID-19 crisis, there has been increasing talk of a so-called "green recovery" from the pandemic: an opportunity for individuals and businesses alike to hit reset on their approach to sustainability and the environment.

Sourcing energy from renewable projects, such as wind or solar power, is one of the most effective ways businesses can help to reduce their carbon footprint. Increasingly, companies are entering into Corporate Power Purchase Agreements (CPPAs), whereby corporate buyers contract directly with developers to purchase their electricity, and in doing so, help support the construction of new renewables projects. By entering into these agreements, corporates can demonstrate green leadership, assist in facilitating the "green recovery", and benefit financially from long term fixed prices. We run down eight things corporates should be considering in relation to CPPAs, both in terms of their importance to ongoing sustainable development and the associated legal risks and structures.

1. The sustainable sourcing of energy is a strategic imperative for a growing number of businesses.

Procuring energy from renewables has taken on increasing significance for businesses worldwide. 200 major companies have signed up to the RE100 initiative, committing to sourcing 100 per cent of their energy from renewables by 2030. It is estimated that in order to meet this target, organisations will need to purchase an additional 210TWh of clean energy, much of which is likely to come from CPPAs.

2. A "green recovery" will require corporate leadership.

The COVID-19 pandemic has helped shed additional light on environmental issues. Air pollution has dropped significantly in many global cities, carbon emissions have fallen, and rivers are running clearer and cleaner than at any point in recent memory. In June 2020, 143 leading UK organisations penned an open letter imploring the UK government to ensure that the UN's Sustainable Development Goals (SDGs) play a vital role in any recovery plan. With the UK currently on track to miss its target of net-zero emissions by 2050, corporates have an important role to play in proactively contributing to lower emissions in a post-COVID world. Sourcing energy through CPPAs may offer one attractive avenue through which this can be achieved.

3. UK renewables are increasingly subsidy-free.

With the removal in March 2017 of government subsidies in the form of Renewable Obligation Certificates (ROCs), and the continuing difficulty in receiving support through the UK government's competitive Contract for Difference (CfD) scheme, renewable energy projects in the UK are increasingly being funded on a subsidy-free basis, leading developers to seek support for projects directly from corporate buyers. By entering into CPPAs, developers can guarantee a long-term purchaser for a project's generated power, meaning their projects are "bankable" and can secure financing to fund construction. On the flip side, corporate buyers benefit from a competitive fixed price for their energy for the term of the agreement and can hedge against untoward movements in the wholesale energy market.

4. Freedom and flexibility.

CPPAs can provide corporates with a more flexible alternative to traditional private wire agreements, where the source of electricity must be located on-site or near-site. Indeed, in a synthetic structure, the corporate buyer can be located in an entirely different energy market to the developer.

5. Businesses can benefit from predictable energy prices.

Fluctuations in the wholesale energy market make it difficult for businesses to predict the cost of their electricity. CPPAs tend to have a term of anywhere between 10 and 15 years, covering the debt term of the project finance, and can therefore help companies to guarantee long term low electricity prices.

Pricing structures generally come in two forms: (i) fixed price and (ii) discount to market.

Fixed price: In a fixed price structure, corporates lock in a guaranteed energy price for the term of the agreement. The fixed price is generally below expected future prices for energy, as the buyer receives a discount for locking in a price for several years.

Discount to market: Discount to market structures guarantee the buyer a cheaper price of energy than prevailing wholesale prices, and can be complemented with a price cap or floor to ensure the price remains within a range.

6. Credit risk remains a major obstacle.

Offtakers must be suitably creditworthy to help create bankable CPPAs for developers. This can prove difficult for some corporate offtakers, particularly when their credit rating compares unfavourably with traditional utilities that have strong balance sheets. Developers will therefore often require credit support in the form of a parent company guarantee or bank guarantee from the offtaker. Corporates should therefore carefully consider what support they are able to provide, particularly where the CPPA provides a significant percentage of the revenue stream of the project. Multi-buyer CPPAs, described below, can help to mitigate these risks.

7. Corporates tend to contract for the full output volume of a project.

These volumes can be substantial, and corporates need to evaluate their predicted future energy demands before entering into a long-term CPPA. Corporates will often want to see performance targets or guarantees from the developer that ensure the availability of a contractual remedy if the output of the project fails to meet expectations. Developers may not be used to giving these types of guarantees and any targets set are likely to be heavily negotiated. Corporates, however, should look to leverage in negotiations the importance of any CPPA in the development and financing of the project. Without a long-term CPPA, there is no project and ultimately no return for the developer.

8. Multi-buyer CPPAs are an increasingly popular way to help overcome hurdles.

Businesses can group together to help spread credit risk and improve their bargaining power when negotiating power purchase agreements. These multi-buyer CPPAs can be structured to give corporates the flexibility to terminate their participation before the end of the full term, with other consortium members picking up the additional capacity, or the capacity being transferred to a new third party. Corporates should also think about how the output of a project is to be allocated between offtakers in times of stress or as a result of force majeure, where the project may be running at a reduced level of capacity. As the market for CPPAs grows, multi-buyer structures can help further open up the market to smaller businesses that have historically lacked the capacity or appetite to take on the full volume of a project.

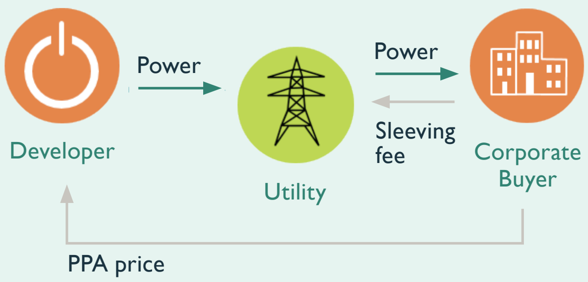
In June 2020, RE100 members wrote an open letter to the EU lobbying for the development of public credit guarantees or risk sharing for renewable projects to be provided by the European Investment Bank. If pursued, such measures could help to open up the CPPA market and lower some of the barriers to entry faced by corporates.

CPPA Structures

CPPAs come in two major forms: (i) Sleeved / Physical, and (ii) Synthetic / Virtual

Sleeved / Physical

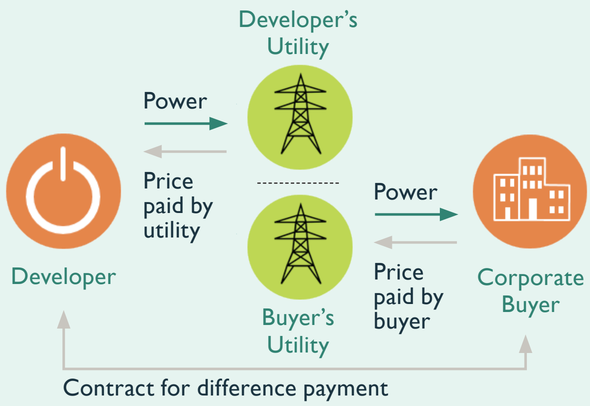
Energy purchased by the corporate offtaker is 'sleeved' through a traditional utility, often via a back-to-back supply arrangement. The utility handles the power for a fee and takes on any risk of intermittency to ensure the offtaker receives a constant and sufficient supply.



Corporates considering using a sleeved structure will need to check the compatibility of their existing supply arrangements with sleeving arrangements, and should also be aware that a long-term sleeving arrangement may affect their flexibility to change supplier in the future. Due to the competing interests of three different parties, sleeved PPAs can be complex and difficult to negotiate, but corporates gain the benefit of developing relationships with two entities at two different levels of the electricity supply chain.

Synthetic / Virtual

No physical transfer of energy takes place between the developer and buyer in a synthetic structure. Instead, the buyer enters into a normal supply arrangement with a utility and separately enters into a hedging agreement (often in the form of a contract for difference or options agreement) with the developer to ensure it pays a fixed price for its power.



Synthetic CPPAs are much simpler and quicker to negotiate, being between only two parties and having fewer moving parts than their sleeved equivalents. Corporate offtakers may choose to benefit from this added flexibility by entering into separate agreements with several developers.

Corporates in the UK have tended to favour the sleeved structure, which provides a more direct link to the sustainable generation of power. Conversely, synthetic agreements are more popular in the US, but are beginning to gain traction in Europe due to their contractual simplicity. It is important to note that despite lacking a direct link to the power generated, synthetic structures still meet the criteria for 'additionality', in the sense that they help additional renewable energy capacity enter the power market. This is important for corporates, such as those in the RE100, who are seeking to meet sustainability targets.

Contacts

Susan Hughes
Partner
E susan.hughes@slaughterandmay.com
T +44 (0)20 7090 5155

Alexander Dustan
Partner
E alexander.dustan@slaughterandmay.com
T +44 (0)20 7090 3573

Samay Shah
Partner
E samay.shah@slaughterandmay.com
T +44 (0)20 7090 5104

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