Dr. Carmen Schneider
PPAs – commercial hype, legal solutions
hands on examples for structuring offshore wind PPAs

WINDFORCE Conference 2019
Bremerhaven
22 May 2019

CHATHAM PARTNERS

A PPA revolution?

- significant cost reductions in the renewable energy sector
- end of support regime under Renewable Energy Act (***EEG***)
  - for existing plants whose funding period ends (2021: approx. 4 GW, until 2025: 2.4 GW/a wind energy)
  - for new plants
    - already '*0.00 ct/kWh-award*' for offshore projects of Ørsted and EnBW
    - surcharge value < possible revenue on the electricity market?
- electricity producer requires constant/secured cash flow
- more and more companies are pursuing sustainability strategies and want electricity from renewable sources

- **solution: <u>P</u>ower <u>P</u>urchase <u>A</u>greements**

A PPA revolution?

- Clean Energy Package of the EU Commission: Directive of the European Parliament and of the Council on the promotion of the use of energy from renewable sources – ***RED II:***
  - legal definition of *renewables power purchase agreement* = contract under which a natural or legal person agrees to purchase renewable electricity directly from an electricity producer
  - Member States to
    - remove regulatory and administrative barriers; and
    - encourage the conclusion of such contracts, and
    - ensure that they are not subject to disproportionate or discriminatory processes or costs
- existing barriers to the direct marketing of electricity from renewable sources by means of PPAs are to be removed in all Member States from mid-2021 onwards

Opportunities and risks

for the electricity producer

opportunities:

- fixed purchase commitment
- for a defined volume in a defined period of time
- at a fixed price
    - stable cash flow
    - project financing (planning security)

risks:

- fluctuating electricity production must be balanced out
- long-term price fixing requires adaption mechanisms in case of unforeseen market turbulences
- risk of legislative changes/market development

Opportunities and risks

for the offtaker

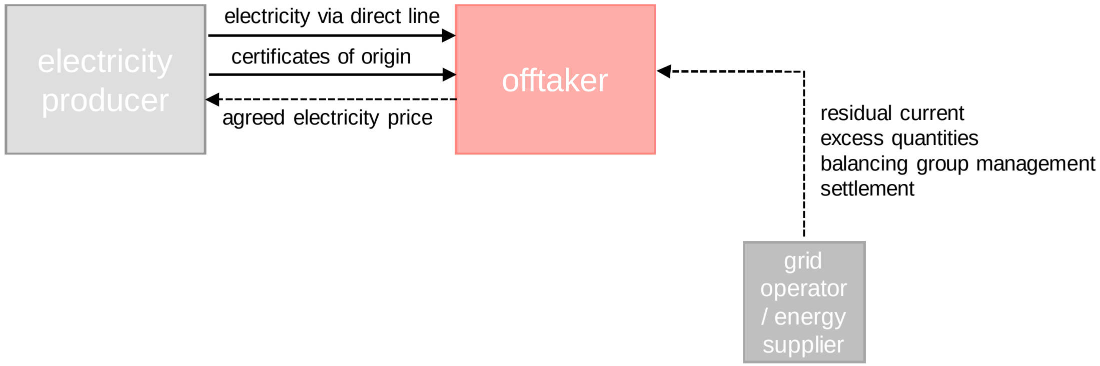
opportunities :

- direct contract with the electricity producer; no further trade margins and transaction costs
- long-term price hedging ensures budget security; no/lower dependence on market prices/fluctuation of market prices
- (physical) delivery of RES-E from a *presentable* plant, incl. certificates of origin → first mover image

risks:

- long-term price fixing and purchase obligation
- PPA as a complex contract → possibly elaborate internal approval process (financial guidelines)
- fluctuating electricity production must be balanced out

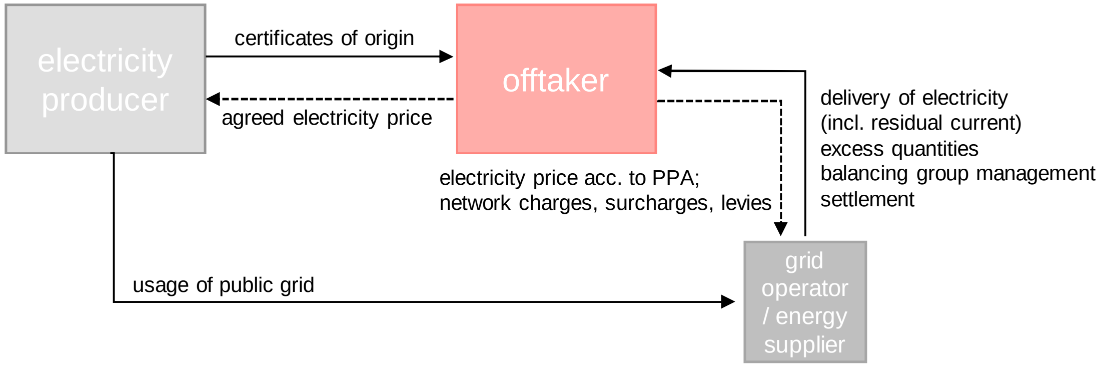
Types of PPAs – on-site



- direct physical delivery
- no use of public grid, therefore no network charges; other charges/levies are being eliminated or reduced
- generator serves as energy supplier/electricity supplier (***EVU/EltVU*** as defined by the Energy Industry Act (***EnWG***)/EEG
- improved security of supplies (no network congestion)
- individually tailored PPA and plant
- CoOs are delivered
- visible marketing tool

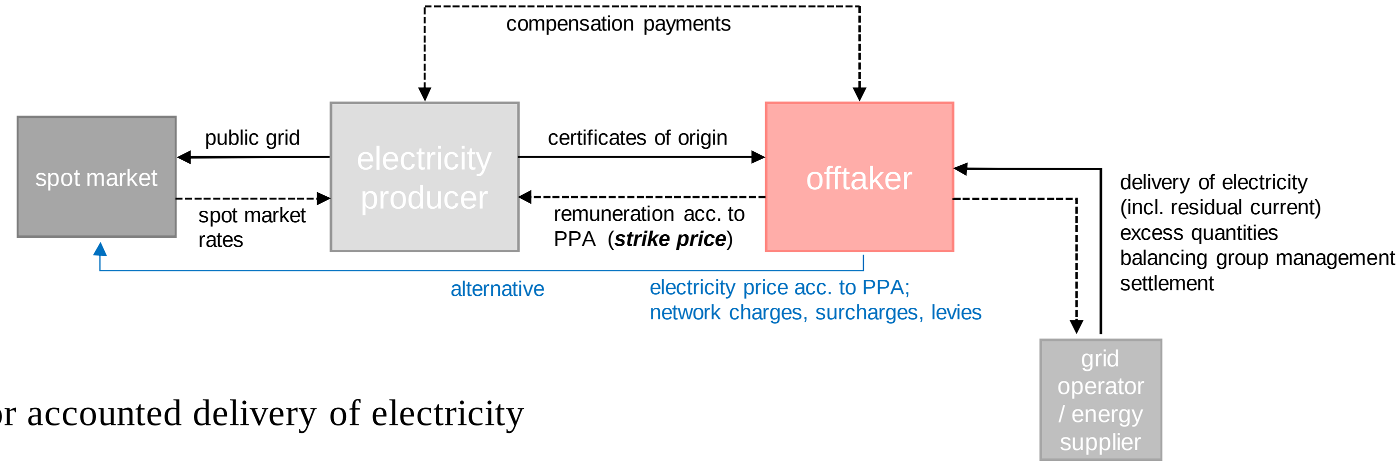
CHATHAM PARTNERS

Types of PPAs – off-site



- no geographical proximity required; locational advantage usable
- financial electricity delivery
- security of supplies stays with the grid operator/energy supplier
- individually tailored PPA
- guaranteed remuneration for electricity producers
- CoOs are delivered
- supply of multi-site customers; third-party sales

Types of PPAs – synthetic/virtual



- no physical or accounted delivery of electricity
- individually tailored PPA; may be regarded as a derivative and therefore subject to approval pursuant to section 32 of the German Banking Act (***KWG***)
- no geographical proximity required; locational advantages usable
- economies of scale possible; possibility of supply of multi-site customers; third-party sales
- long-term market price risk for offtaker; electricity producer secures cash flow through strike price (Contract for Difference '***CfD***') → variety of configuration options (take-or-pay, minimum prices, indexation …)
- security of supplies stays with the grid operator/energy supplier

Legal framework

- PPA = energy supply contract within the meaning of section 3 no. 18a EnWG; purchase agreement, Sec. 433 German Civil Code; contract for the performance of a continuing obligation
- electricity producer
  - becomes an EVU/EltVU within the meaning of the EnWG/EEG depending on the design of the PPA
  - must comply with the relevant regulatory provisions: e.g. notification/storage and publication requirements, electricity labelling requirements
- supply of electricity on the basis of PPA is a form of other direct marketing within the meaning of section 21a EEG 2017 (exception: on-site PPA, '*neighbor supplies*') → no statutory promotion
- Sections 21b, c EEG 2017 shall apply to the change to other direct marketing

Structure – pain points

- fixed price/minimum/maximum price per kWh, price corridor, mixed prices, seasonal distinction…
- for long-term PPA: price sheet with (unilateral) price adjustment mechanism (indexation) - core of the PPA
- purchase
    - ‘*take or pay*’ or ‘*take and pay*’
    - place of fulfilment, delivery quantity, balancing
    - baseload delivery (fixed-volume) or as-produced/as-forecasted (plus cost of residual current/balancing energy used)
- liability/risk distribution for (un)planned non-availabilities, disturbances/interruptions (also in the grid)
- term
    - in the case of long-term PPAs: termination rules must be well-considered; if the contract price and market price diverge noticeably over a significant period of time, the disadvantaged party may otherwise be inclined to terminate the contract prematurely; termination payment/final payment
    - right of the general terms and conditions
    - competition law regulations to be observed, if applicable
- change of law (compensation rules, curtailment measures, compensation for feed-in management measures; CoOs)

State aid for indirect CO_2 costs of emission trading

locking electricity-intensive companies out of the PPA market

- indirect CO_2 costs are caused by the fact that electricity generators are passing on the costs of emission allowances to their customers via electricity price
- the aid is intended to compensate for some of these costs for undertakings in certain electricity-intensive sectors and subsectors mentioned in Annex II of the EU State Aid Guidelines → aid linked to electricity consumption of installations
- interpretation of German Emissions Trading Authority (DEHSt): in case of electricity supply contracts that do not include any CO_2 costs, no State aid will be granted
  - delivery contracts, which serve as a basis for the supply of CO_2-free electricity (= volumes sourced under an offshore PPA) are excluded from State aid
  - industrials in receipt of State aid have an incentive to source grey power
- EU State Aid Guidelines will expire end of 2020; currently: revision in the context of greenhouse gas emission allowance trading system; several options of how to address the risk of carbon leakage due to indirect CO2-costs in the EU State Aid Guidelines are assessed
  - public consultation was closed 16 May 2019
  - Commission adoption planned for Q3/2020

Pain points from a financier's point of view

- creditworthiness of the offtaker
  - banks may demand additional collateral under the facility agreement
  - off-site/synthetic PPAs: offtaker, e.g. a trading house, assumes the market price risk and may have to back risk capital for this purpose
  - prerequisites for termination for good cause: clearly defined and with an appropriate remedy period, including periods for the financing banks to exercise their rights under the direct agreement.
- in case of physical delivery: taking into account the risk that delivery is possible at the delivery point
- assignability, direct agreements
  - standard security
  - assignment of rights (payment claims) under the PPA to the financing bank(s)
  - financier’s right to cure the offtakers's cause for termination
  - entry/take-over rights of the financing bank(s) → direct agreements
- force majeure, omission/disruption of purpose → detailed risk matrix/risk allocation

Dr. Carmen Schneider

Dr. Carmen Schneider is a partner at Chatham Partners LLP. She advises market participants in all areas of energy law, with a focus on project development, in particular in the areas of renewable energies (on- and offshore wind farms) and decentralised generation (contracting, storage concepts, decentralised supply models in the housing industry, tenant electricity and self-supply solutions).

Dr. Carmen Schneider also advises on energy contract law, regulatory and energy trading. Recently, she has increasingly advised clients in connection with the implementation of blockchain solutions in the energy industry (e.g. peer-to-peer trading platforms).

Contact

T + 49 (0)40 303 963 20
M + 49 (0)160 930 357 19
E carmen.schneider@chatham.partners

CHATHAM PARTNERS

Any Questions?

Chatham Partners LLP
Neuer Wall 50
20354 Hamburg

Telefon: +49 40 303 963 (-0)
www.chatham.partners

Thank you very much for your attention.