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CORPORATE PPAs

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Power purchase agreements are no longer the exclusive domain of retailers. As electricity prices rise and we move towards a carbon-constrained future, companies are looking for ways to manage their exposure to changing electricity prices and to purchase electricity from renewable sources. Generators are also looking beyond retailers as potential offtakers to support the development of new renewables facilities. Consequently, over the past year power purchase agreements with corporate offtakers (***Corporate PPAs***) have become increasingly popular in Australia.

As a leader in renewable energy projects in Australia, Allens has played a significant role acting for offtakers, generators and financiers on some of the largest renewables projects in the country. We are now applying this expertise in the emerging market for Corporate PPAs and have advised on ground-breaking Corporate PPAs in a variety of different industries that have involved innovative structuring and negotiation of complex key issues. This interactive PDF aims to give you a snapshot of this emerging sector.

STRUCTURES

Over the past year, a number of alternative structures for Corporate PPAs have emerged in the Australian market. These include buying groups, and arrangements which facilitate a fixed quantity offtake (which is challenging for a variable generator) to the offtaker.

Click here to see some of the different ways Corporate PPAs can be structured.

KEY ISSUES

Corporates are accustomed to dealing with retailers and their standard retail contracts. Generators (and their financiers) are used to dealing with retailers as offtakers, with generally accepted and understood ideas of what is 'market' for a power purchase agreement.

There has been a learning curve for generators, financiers and corporates in relation to Corporate PPAs – with all parties having to re-examine previous market practice and understand the commercial drivers of the others to negotiate an outcome that is acceptable to all.

Click here to see some of the key issues that arise in negotiating Corporate PPAs.

CONTACT US

We are at the forefront of advising on renewables projects and Corporate PPAs across Australia, and we would be delighted to meet with you to discuss our experience and insights.

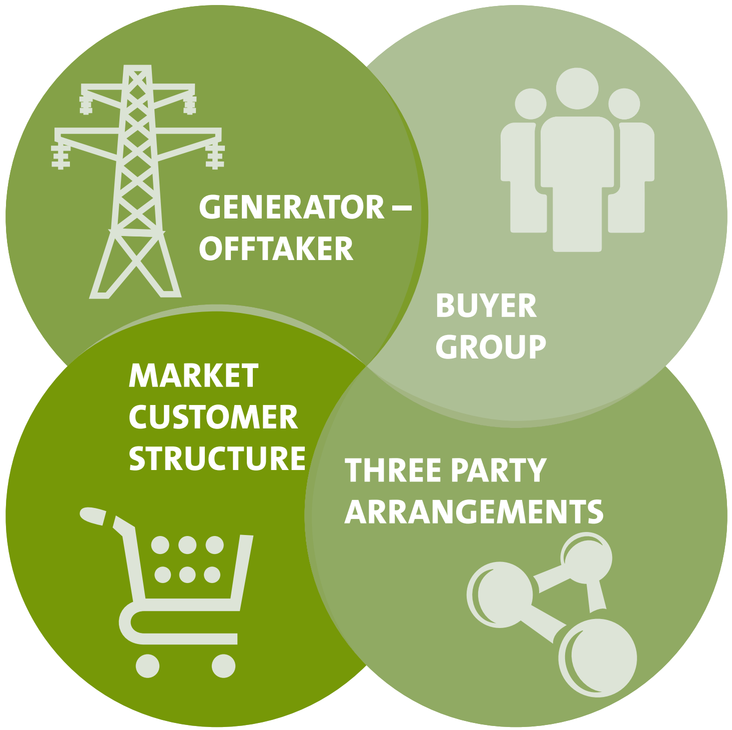
Click here to find out more about the deals we have been involved in and how to get in touch.

STRUCTURES

Companies looking to enter into Corporate PPAs can come from any industry or a group of industries where the load is large enough to support a generator's project either in part or as a whole. Banks, local councils, water corporations, energy-intensive industry and universities have all ventured (or are looking to venture) into the world of Corporate PPAs.

The wide variety in the type of corporate entity seeking a Corporate PPA means that there is also a range of commercial drivers behind entry into one. Further, the electricity industry is highly regulated, with set roles for generators, retailers and customers, which means that there can be significant regulatory barriers for electricity users to contract directly with a generator.

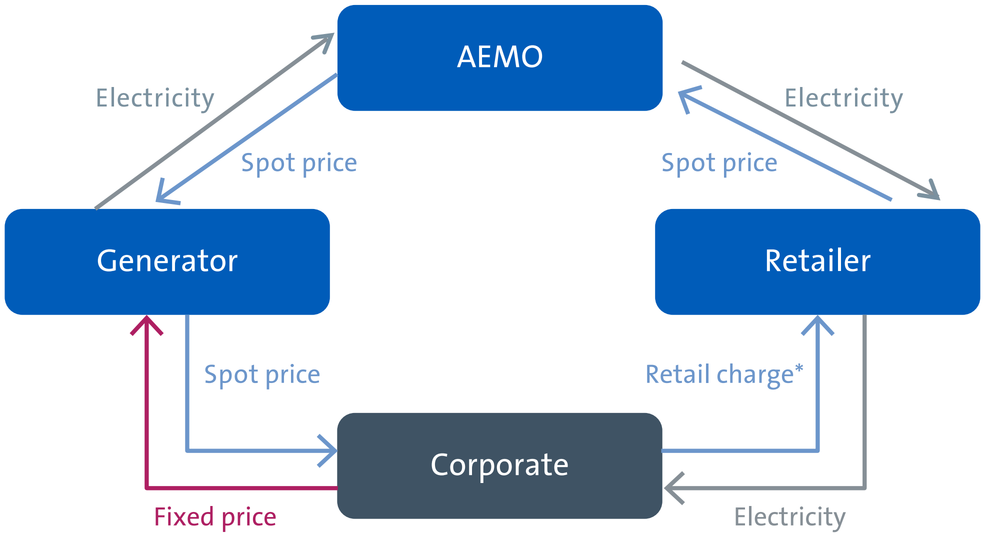
Generators and corporates have been innovative in tailoring the structure of their Corporate PPAs to suit the individual needs of a particular deal and to overcome these regulatory barriers. We have set out some of the types of structures that we have seen.



GENERATOR – OFFTAKER

This structure provides the most straightforward option we have come across, and involves the corporate entity retaining its standard retail contract and entering into a hedge (the Corporate PPA) with the generator to offset some or all of its exposure under its retail contract. This structure involves the corporate entering into a derivative for the purposes of the *Corporations Act 2001* (Cth) (because the hedge references the spot price) but does not require the corporate to be a market participant (because the corporate retains its retail contract, and the retailer performs that function).

GENERATOR – OFFTAKER
BUYER GROUP
MARKET CUSTOMER STRUCTURE
THREE PARTY ARRANGEMENTS



*Retail Charge is usually partially linked to the spot price.

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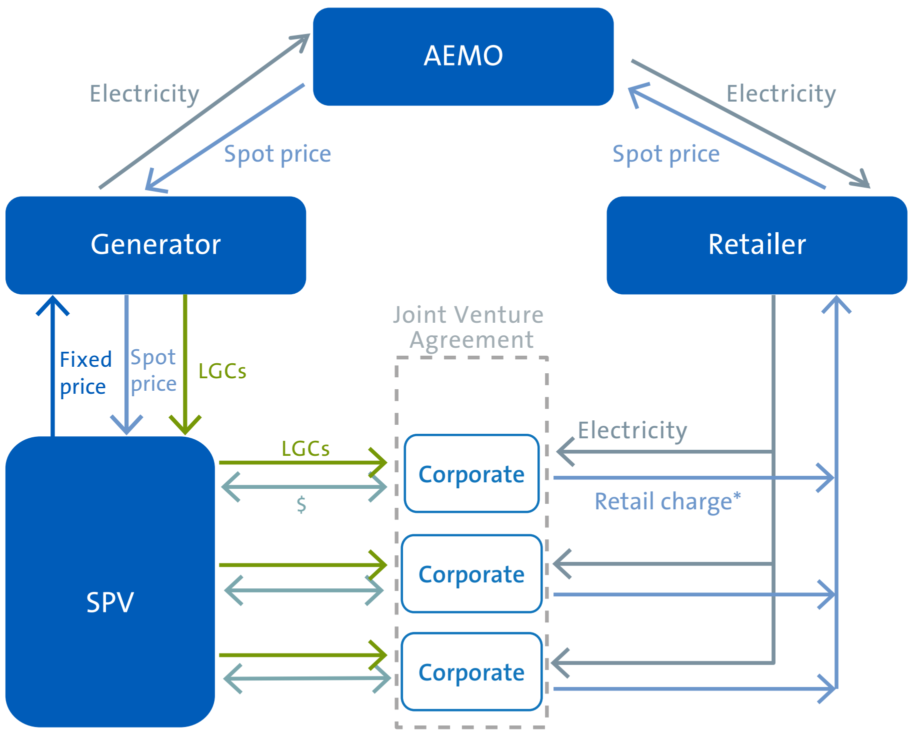
BUYER GROUP

A single corporate does not necessarily have the load size to support the development of a new renewable facility or to be attractive to a generator. To overcome this, corporates are joining together as a buyer group to increase their aggregate load size and, subsequently, their negotiating power.

GENERATOR – OFFTAKER
BUYER GROUP
MARKET CUSTOMER STRUCTURE
THREE PARTY ARRANGEMENTS
ANOTHER OPTION

BUYER GROUP – ONE OPTION

One of the issues that a generator faces with a buyer group is putting in place (and managing) multiple contracts. This structure allows the generator to enter into the Corporate PPA with a single entity (eg a special purpose vehicle (***SPV***)). The arrangements between members of the buyer group (which could take the form of a joint-venture agreement for example) and which determine how the buyer group receives the benefits under the Corporate PPA can sit behind the Corporate PPA and can largely be ignored by the generator so long as the entity entering into the Corporate PPA is creditworthy or provides appropriate credit support. The individuals in the buyer group also continue to source their electricity from individual retail contracts.



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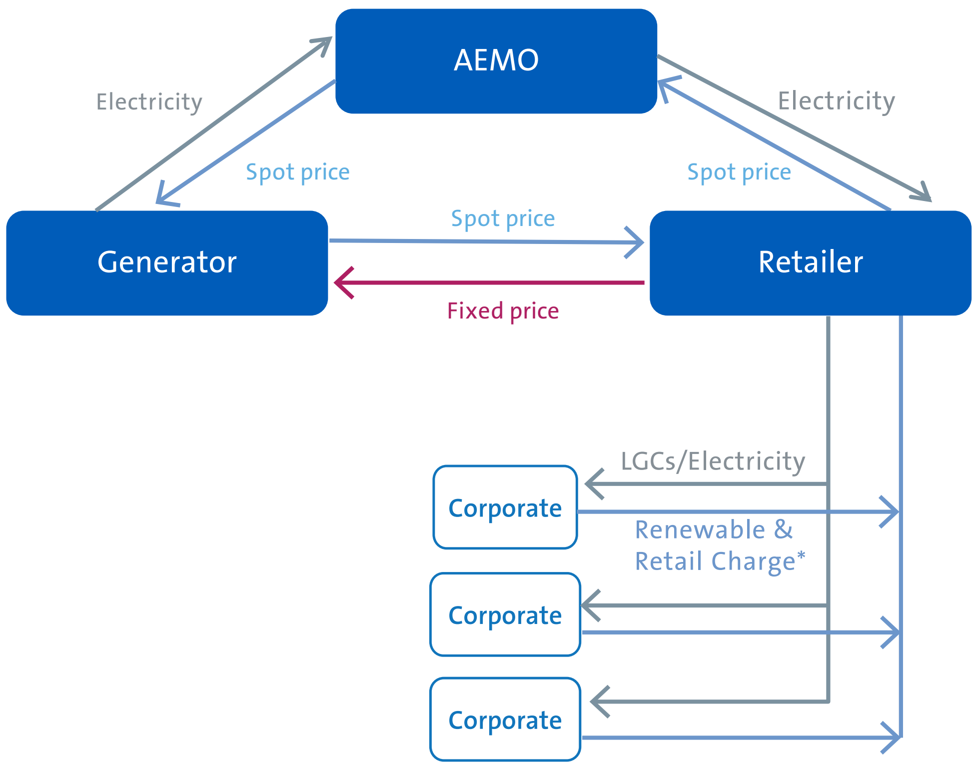
BUYER GROUP – ANOTHER OPTION

Another structure we have seen used by a buyer group is for the buyer group to engage a retailer to enter into and manage the Corporate PPA on behalf of the buyer group. The retailer then provides retail services to each of the entities in the buyer group as well as passing through the benefits of the Corporate PPA to the buyer group under individual retail contracts.



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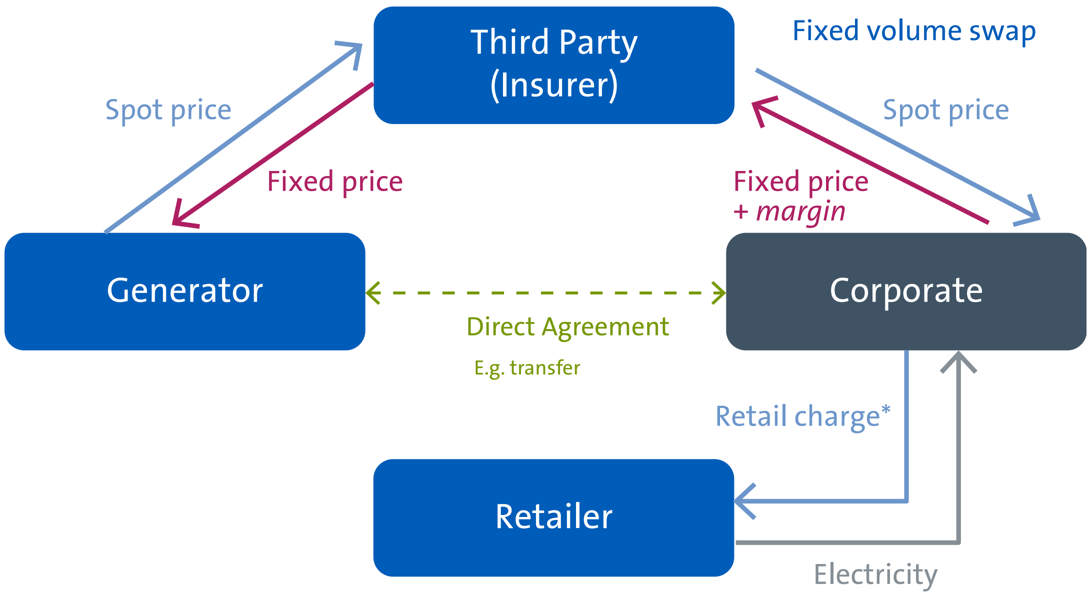
THREE-PARTY ARRANGEMENTS

A novel, but more complicated option, is to bring in an additional third party whose business is to hedge commodities like electricity (such as an insurer). In such a case, the insurer takes the risk on the spot price and the volume of electricity generated by the generator, and enters into a fixed-volume and fixed-price derivative arrangement with the corporate offtaker, taking a margin in the process. The benefits of this arrangement for the corporate include being able to get a fixed volume for a fixed price and possibly over a shorter period or with an option to terminate. The corporate and generator may or may not have a direct agreement in place in relation to other matters such as the transfer of large-scale generation certificates. The corporate continues to source its electricity under its retail contract.



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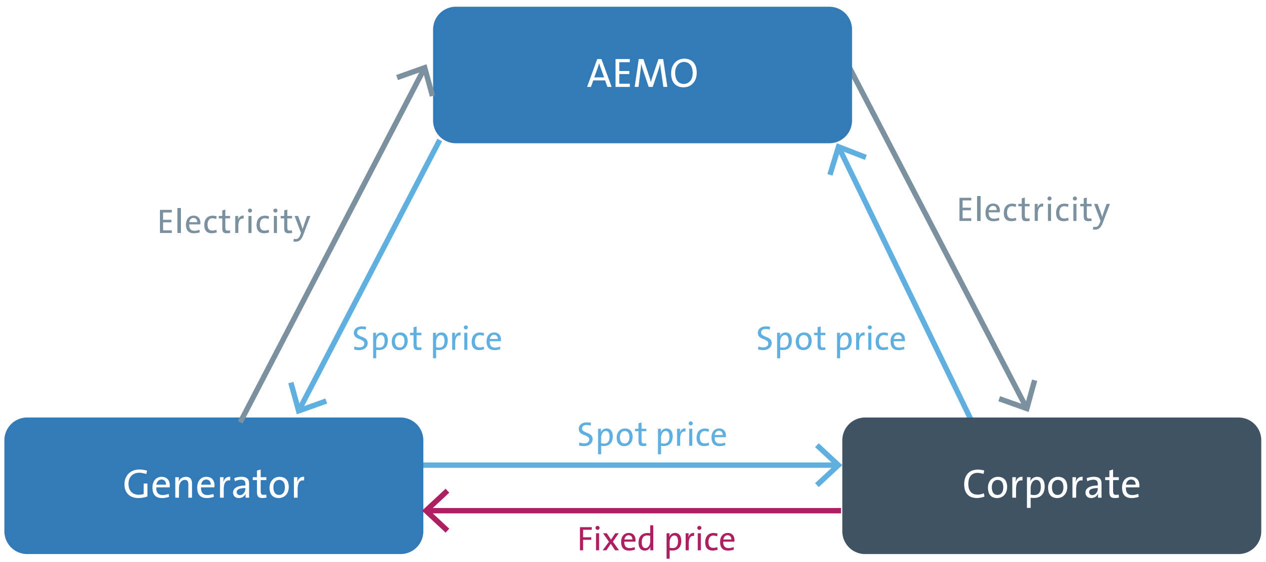
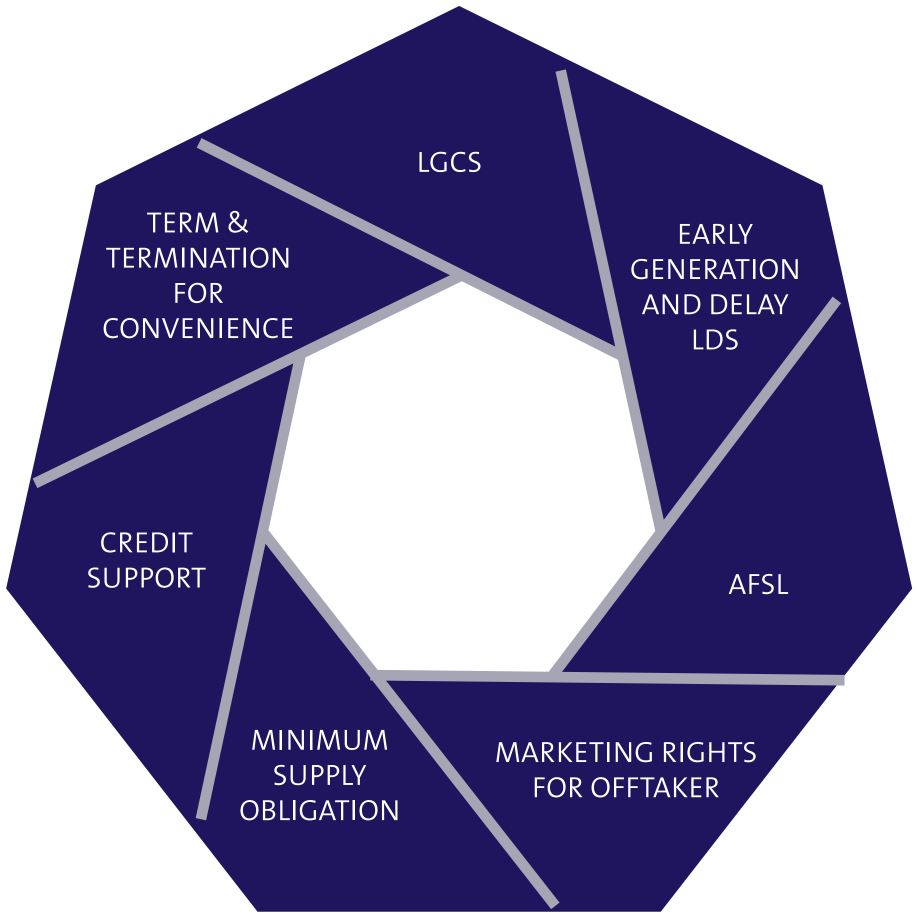
MARKET CUSTOMER STRUCTURE

As an alternative, it is possible for the corporate entity to register to participate directly in the market as a Market Customer. This option allows the corporate to cut out the 'middle man' (ie, a retailer) by removing the requirement for the corporate to hold a retail contract, and would enable the corporate to purchase electricity directly from the grid at the spot price and hedge these prices under a Corporate PPA with a generator. This structure is not commonly used in Australia, most likely because of the costs and regulatory requirements associated with registering as a Market Customer.



KEY ISSUES

In our experience advising on Corporate PPAs, we have seen certain issues consistently being the subject of negotiation between the counterparties (and of concern to financiers). These are set out below. While some of these issues are also commonly negotiated in traditional PPAs (eg credit support), others are more specific to Corporate PPAs (eg termination for convenience). Further, issues which the market recognises from traditional PPAs often require consideration from a different perspective when dealing with a Corporate PPA (eg AFSL).



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TERM & TERMINATION FOR CONVENIENCE

Generators, particularly those who require a power-purchase agreement to underpin any project financing for their project, require longer-term agreements. We have traditionally seen generator-retailer power purchase agreements of around 10-15 years or with an end date of 31 December 2030 to coincide with the expiry of the Renewable Energy Target scheme.

Such a long-term commitment can spook corporate buyers who are used to entering into much shorter retail contracts. Consequently, corporates have sought to include termination for convenience clauses in their Corporate PPAs.

Such clauses are unusual in generator-retailer PPAs; however, in our experience, generators have been open to the inclusion of such a clause if an early termination amount is payable by the corporate entity or the price under the Corporate PPA reflects the additional risk that the generator takes on if such a clause is included (and where financiers are involved, any termination amount is likely to need to be sufficient to allow repayment of the generator's debt).

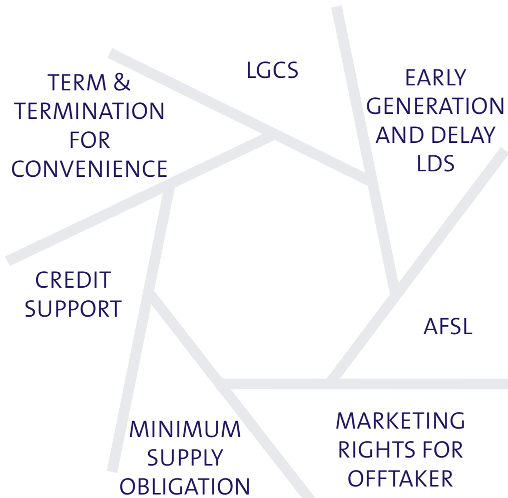
CREDIT SUPPORT

For generators and their financiers, a key focus in securing a power purchase agreement is the creditworthiness of the offtaker. In a traditional generator-retailer power purchase agreement, the retailer is required to have an investment-grade credit rating or provide suitable credit support (eg a parent company guarantee from an entity with an investment-grade credit rating or a suitable bank guarantee).

Corporates, and particularly large corporates that are not used to having their creditworthiness questioned, even if the contracting entity is not rated, often do not understand the need for this requirement and may face difficulties gaining internal approvals to provide credit support where it is not usual practice.

To overcome this issue, we have seen parties negotiate credit-support triggers such as a change to a company's net debt-to-net worth ratio or a decrease in the net asset level by a certain amount. Another credit-support trigger we have seen negotiated is if the corporate entity ceases to be party to its parent's deed of cross-guarantee.

This issue remains live, and the outcome of the negotiations depend on who the contracting counterparty is and how willing the generator is (and its financiers are) to move away from the traditional credit support provided by retailers.



MINIMUM SUPPLY OBLIGATION

Quite often, particularly in early days of renewable power purchase agreements, retailers were happy to accept whatever generation a renewable generator provided. However, obligations to meet minimum supply levels are becoming increasingly common in generator-retailer power purchase agreements, albeit at low threshold.

Corporates often have set loads or a certain percentage of their load that they want renewable energy generation to hedge. Accordingly, it is common for minimum supply obligations to be included in Corporate PPAs as well as liquidated damages being payable if those obligations are not met.

The minimum supply obligations generally are set on an annual basis to allow seasonality of renewable generation to be taken into account. Additionally, it is common to see minimum supply obligations adjusted for force majeure events, network constraints and unplanned maintenance. Given the requirement of corporates to receive certain volumes of renewable energy generation, corporates will generally push for less carve outs to be included in the minimum supply obligation.

Given minimum supply obligations are becoming increasingly common in generator-retailer power purchase agreements, the inclusion of such a clause is not usually an issue in a Corporate PPA. The negotiation then becomes around what level the minimum supply is set at, what carve outs (if any) will be included and how the liquidated damages are calculated if the minimum supply obligations are not met.

MARKETING RIGHTS FOR OFFTAKER

One of the reasons why corporates may wish to enter into a Corporate PPA with a renewable generator is associated with the green credentials that arise off the back of that agreement.

On this basis, it is common for corporates to seek a right to be able to use the renewable project's name and information in its marketing material. In some instances, corporates seek further rights, such as being able to install signage at the project site or requiring that the generator only deliver environmental certificates that have been created by reference to that particular renewable project.

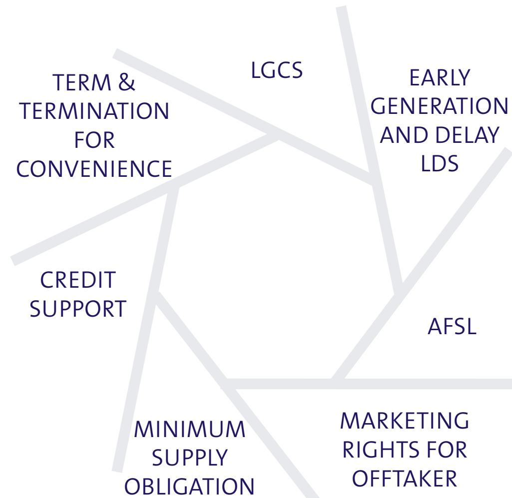
These rights are generally uncontroversial, although the generator may seek consent rights (particularly in relation to the installation of any signage or other marketing material at the project site) or the ability to source environmental certificates from other renewable sources if it cannot meet any minimum supply obligations from its project.

AFSL

One of the key issues that arise in generator-retailer power purchase agreements as well as Corporate PPAs is whether an entity requires an Australian financial services licence (***AFSL***) to enter into that agreement.

This is less of an issue for retailers, as the number of power purchase agreements entered into by a retailer will usually necessitate that the retailer obtain an AFSL. However, for corporates, or generators which are set up as special-purpose vehicles for particular developments, it is usually necessary to analyse the transactions contemplated by a power purchase agreement to determine whether an AFSL is required.

The reason an AFSL may be required is that the transactions contemplated by a power purchase agreement often fall within the broad definition of a 'derivative' under the *Corporations Act 2001* (Cth). If none of the exemptions under the legislation apply, then the entity (whether it is the generator or the corporate) will either need to obtain an AFSL or obtain the services of a third party who holds an AFSL to act as an intermediary.



EARLY GENERATION AND DELAY LIQUIDATED DAMAGES

Retailers have traditionally been comfortable in accepting pre-commissioning generation, and generation from the date the generating plant has been fully commissioned without needing a fixed commencement date as the load is part of the retailer's broader portfolio.

However, corporates tend to have fixed requirements for commencing trading under a Corporate PPA, which can range from internal accounting purposes to reporting requirements or aligning the Corporate PPA with the commencement of a new retail contract, and appear to be less interested in pre-commissioning generation.

Accordingly, we are seeing an increase in liquidated-damages clauses being inserted if there is a delay in the construction of a renewable facility. While generators are generally comfortable including such a clause, the method for determining the liquidated damages for delay can be a point of negotiation.

LGCS

Under generator-retailer power purchase agreements, retailers look to purchase the large-scale generation certificates (***LGCs***) available from a renewable energy generator in order to satisfy their regulatory obligations. However, retailer demand for LGCs may be on the decline given recent forecasts suggest that the Renewable Energy Target has been (or will shortly be) met.

Whether a corporate wants to purchase the LGCs will usually depend on the reasons why the corporate is entering into the Corporate PPA in the first place.

For corporates whose primary purpose for entering into a Corporate PPA is cost savings, LGCs seem to be less important and often these corporates look for electricity only Corporate PPAs. An exception to this is where the corporate can use the LGCs to manage their exposure under their retail contracts. However, as mentioned above, this driver may cease to be relevant as retailer demand for LGCs is declining.

On the other hand, for corporates who are entering into a Corporate PPA for the green credentials or to meet specific targets relating to renewable energy generation (eg emissions-reduction targets or promotion of renewable energy in a particular jurisdiction), LGCs can be an important tool for demonstrating that the entity is achieving those aims. In such situations, the vintage and source of the LGCs also become important. Given this driver for purchasing LGCs operates independently of retailer demand for LGCs, corporates requiring LGCs for these purposes may continue to purchase them even once the Renewable Energy Target has been met.

CONTACT US

Our team has been involved in a number of corporate PPA negotiations, acting for both generators and offtakers and our involvement in acting for clients on Corporate PPAs dates back to advising Tomago Aluminium on its agreement with Macquarie Generation. We understand the issues that offtakers and banks focus on when negotiating PPAs, and also the key challenges and risks in selling electricity and environmental products produced from renewable energy generators. We also have significant experience in electricity procurement and a thorough understanding of what it takes to develop projects in the renewables sector.

Our corporate PPA experience has included advising:

- Orora Limited – on its negotiation and execution of two Corporate PPAs – one with Pacific Hydro's operating Clements Gap Wind Farm, and the other with the owners of the Lal Lal wind farm project.
- Commonwealth Bank of Australia – on its corporate PPA with CWP Renewables and associated retail contract in respect of the Sapphire Wind Farm and proposed solar and battery project.
- Sydney Airport – on its corporate PPA with CWP Renewables and associated retail contract in respect of the Sapphire Wind Farm and Crudine Ridge Wind Farm.
- Intelligent Water Networks – on its procurement of a corporate PPA in respect of the Kiamal Solar Farm, including preparation of full form PPA documentation for a request for proposal.
- Southern Sydney Regional Organisation of Councils – on its negotiation and execution of a power purchase agreement with Origin Energy in respect of the Moree Solar Farm.
- First Solar – on its power purchase agreement with TfNSW in respect of the Beryl Solar Farm.

We are also currently advising on a number of other Corporate PPAs (adopting a variety of structures and for clients across multiple sectors) which remain confidential.

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