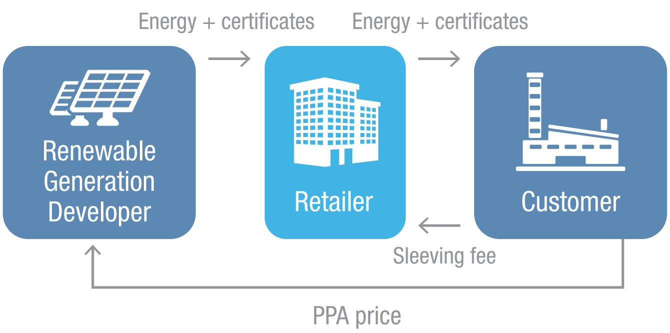
The Power and Perils of a Corporate Power Purchase Agreement (PPA)

Educate yourself, **evaluate** the options and **mitigate** the risks

What is a Corporate PPA?

Corporate PPAs are a recent addition to the toolbox of options for business users to procure their electricity. There is currently no standard form for these contracts, each Corporate PPA is negotiated from the ground up by the generation project and the business consumer. Whilst there are a variety of different features that vary between deals, the underlying principal is for the business consumer to purchase electricity via a long term (10+ years) agreement directly from the generation project at the generator's factory gate.



This is an example PPA – There are alternate models.

Typically, this long term contract means the agreed prices are significantly below market rates for typical retail electricity contracts. Despite the immediate cost advantage, their long term arrangement spanning 10 years or more can introduce substantial price risk for later years.

Corporate PPAs also present multiple other risks that need to be understood and managed by a client considering entering into a PPA agreement. Energy Action's Trading and Pricing team and Advisory Services division have worked with a number of clients to evaluate these risks and can help organisations manage these risks and their exposure if possible.

5 Attractive Powers

1 Corporate Branding – Entering into a Corporate PPA is perceived as progressive and innovative, the corporate customer is contributing to the disruption of the traditional energy "gentailer" market. High level of consumer, media, staff and stakeholder interest and plentiful photo opportunities.

2 Direct Supply – Eliminate the middle man (retailer) by buying direct from the source of a renewable project – wind or solar

3 Price Certainty – The ability to lock-in firm prices for the long term, reducing volatility and improving the ability to budget and forecast electricity costs

4 Regulatory Certainty – A Corporate PPA helps you take control in the vacuum of regulatory certainty relating to emissions and renewable targets

5 Sustainability – Corporate PPA's underwrite the development of renewable asset infrastructure and have a direct contribution to lower emissions as customers and industry move to a low carbon future

Call us today to discuss your procurement strategy and whether a Corporate PPA is a good fit for your business.

11 Perils of Corporate PPAs

While Corporate PPAs present an opportunity for organisations to take control of their emissions and renewables targets, lock in discounts to the elevated energy price, and underwrite renewable asset infrastructure, we have identified a number of risks to be considered in conjunction. These include:

1. Price Risk – While potentially offering a discount on the current retail price, there may be circumstances where in 3, 7 or 10 years, the PPA price will be 'out of the money'.

2. Firming Cost – The direct supply cost may be low, however the premiums required to "firm" and manage the mismatch between project supply and your demand may be considerable, especially as retailers are increasingly bound by regulation to underwrite firm retail contracts.

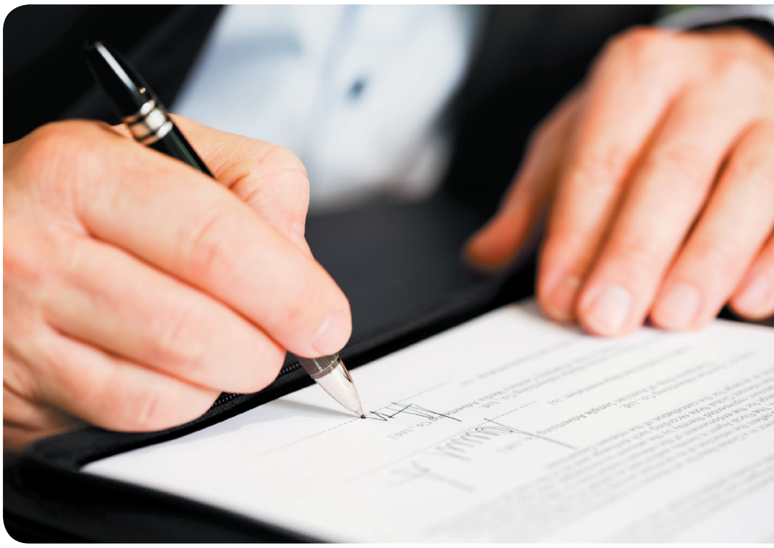
3. Operational Risk – Will the project achieve nominal output, or will uncertain, and often substantial Marginal Loss Factors (MLF), impact on the economic output. And what happens if there is plant failure or loss of connection.

4. Counterparty Risk – Will your counterparty be there through the life of the agreement; your balance sheet will be subject to their viability. Some agreements also demand bank guarantees as security.

5. Contracting Risk – This is a young, complex and emerging market place, with limited customer and market experience for sophisticated agreements. Legal costs may be high as there are no industry standard ESA or standards to guide agreements and each project has unique aspects.

6. Project Risk – There is a financial impact from project delays due to regulatory approvals, construction and grid connection. Renewable projects are more susceptible to project delays.

7. Derivative Exposure – Many organisations are unable to accept the uncertainty of certain financial instruments. There are many forms of Corporate PPAs discussed in the public domain and some of these include unhedged price exposure.



8. Basis Risk – In a national market, different prices are set in each state. The physical supply of a PPA may not match a consumer's demand and jurisdiction. This creates additional costs as the reference price for the PPA is not consistent with where electricity is consumed.

9. Term – Most reported PPAs run from 10 to 15 years, in contrast to the traditional corporate customer buying behaviour of 1 to 3 year fixed price agreements. A PPA eliminates the opportunity to periodically reset prices back to market.

10. Regulatory Uncertainty – Generators, Transmission and Distribution networks are heavily regulated and changes in regulations have a substantive impact on the economics of PPA agreements. Changes in the form and type of regulation, impact the payback period, and overall feasibility of market PPAs.

11. Strategic Risk – Boards, management teams and strategies change over time. A long-term contract may not be attractive to these future teams. There may not be the ability to renegotiate an arrangement.