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SELLING YOUR POWER: THE GROWTH IN DIRECT POWER PURCHASE ARRANGEMENTS



Words:
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Burges Salmon

Most people will tell you that the market for the purchase of renewable energy over the last few years has fluctuated as uncertainties surrounding Electricity Market Reform (particularly the new concept of contracts for difference), as well as other potential changes to the electricity markets such as the likely cost of electricity balancing, take their toll. The attractiveness of offers from some of the major electricity suppliers for long-term power purchase agreements (PPAs) has also waned, and those hoping to obtain finance for their projects have had to get used to protracted negotiations over key clauses in PPAs which could impact on the revenue stream for a renewables project, such as change of law, the availability of a floor price and termination triggers. It is probably no surprise, therefore, that renewables developers are now looking more closely at the concept of direct power purchase arrangements, whereby a corporate rather than a traditional electricity supplier agrees to purchase renewable energy direct from the generator.

The concept of direct power purchase arrangements has been around for some years, but the popularity has increased over the last 18 months or so. We have seen a number of corporates looking very closely at procuring renewable energy direct from generators, and these entities include major high street banks, pharmaceuticals and supermarkets, all of which have high energy needs, coupled with carbon and corporate responsibility targets, which when pulled together make purchasing large clips of renewable energy attractive.

Direct PPAs can bring electricity consumers and generators together irrespective of location, generating capacity and supply requirement.

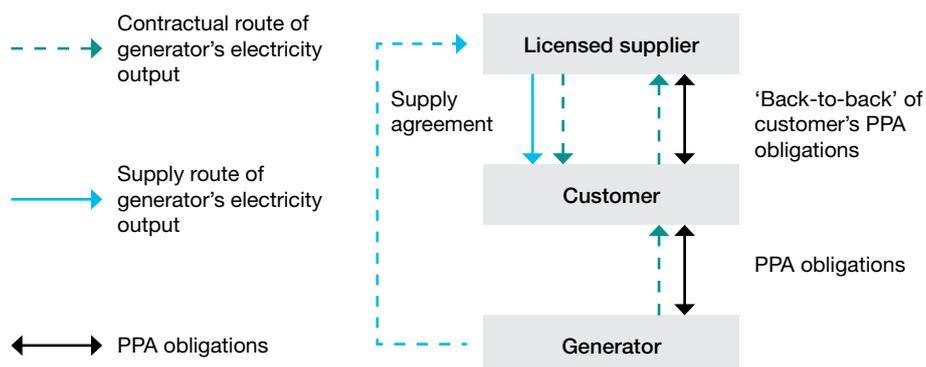
These corporates have also realised, as should the generators, that the window for these direct power purchase arrangements is now fairly

narrow. Once contracts for difference take over from the Renewables Obligation in 2017 as the only mechanism for supporting large-scale renewable generation it is likely that direct PPAs may no longer be as attractive to the generators selling their electricity.

Direct PPAs can bring electricity consumers and generators together irrespective of location, generating capacity and supply requirement. From our experience there are now two contractual structures prevalent in the direct PPA market. The back-to-back or direct PPA structure whereby a corporate customer contracts direct with the generator to take power but back-to-backs that structure with an agreement with its licensed supplier (which supplies the corporate with the remainder of the electricity). A diagram for the back-to-back structure is included in Figure 1 (left).

The other model which has emerged, which Burges Salmon helped devise, is the concept of the contract for difference or price guarantee arrangement. This is where the generator contracts directly with the power off-taker (the licensed supplier) but there is a separate arrangement, a price guarantee arrangement, between the generator and the corporate, which provides a price guarantee mechanism,

Figure 1. The 'back-to-back' direct PPA structure





fixing the power price to counteract market price-driven fluctuations.

In direct PPA structures the generator is not physically supplying the customer directly. Whichever structure is chosen the customer will need an electricity supply agreement which is compatible with a direct PPA structure, allowing the on-selling and crediting arrangements for the electricity.

It is fair to say that these arrangements are more complicated to put in place than a standard PPA with a licensed supplier. However, for those corporates with significant electricity usage, this kind of structure provides considerable benefits, helping spread the risks associated with fluctuations in energy pricing and acting as a hedge against rising energy costs. In addition, it provides the corporate customer with an identified contractual link to a resource of renewable energy generation as opposed to signing up to a more generic green tariff. For those projects that for financing purposes need the best floor price they can get for their electricity, these arrangements can be particularly attractive. Corporates in the direct PPA market have been prepared to offer higher fixed prices than those traditionally available from the licensed suppliers. These higher fixed prices can then be taken into account in modelling

generation income for the purposes of funding.

The number of licensed suppliers who are currently providing direct PPA supply arrangements is increasing. More are likely to come to the market in the next year or so. This is good news for generators and the large energy customers as it will make life easier to put arrangements in place.

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Burges Salmon has advised on Direct PPA arrangements, rolled out many renewable energy projects from the generator and corporate side and regularly advises on 'traditional' on-site and export PPAs and energy supply contracts. If you would like to discuss any issues raised in this paper, or have any queries about renewable energy generation, please contact us.

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■ ■ Biography

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The team advises on all types of renewable energy project including wind (onshore and offshore), wave and tidal, hydro, solar, biomass, geothermal and innovative waste to energy technologies.

Ross advises clients on legal/regulatory aspects of the energy sector including incentives, grid, fuel procurement and power sales. He has substantial experience in marine renewables and offshore wind, covering projects in all Crown Estate rounds