



## Energy Webinar Series Corporate Renewable Energy Procurement: Legal Considerations & Market Trends

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On August 17, 2016, Skadden hosted a webinar titled “Corporate Renewable Energy Procurement: Legal Considerations & Market Trends,” the fourth installment in Skadden’s Energy Webinar Series focused on transactional trends impacting the energy industry. The program, which drew 185 attendees, addressed corporate power purchase agreements (PPAs), including a discussion of the prevailing PPA structures that have emerged as the most common approaches for corporate off-takers, specific key contractual terms and conditions, and additional legal considerations. Speakers from Skadden’s Energy and Infrastructure Projects Group included partners Ann Hawkins (Houston) and Ethan Schultz (Washington, D.C.) and counsel Nike Opadiran (Washington, D.C.).

### Introduction and Industry Trends

Mr. Schultz began the webinar by discussing the recent growth of corporate off-takers procuring renewable energy via physical and synthetic/virtual PPAs entered into directly by corporate procurers and the owners of renewable generating assets. In the past, corporate buyers seeking to procure environmentally sustainable energy typically entered into contracts to purchase unbundled Renewable Energy Credits (RECs) or bought “green” power via regulated utility tariffs, with a subset of buyers successfully structuring commercial and industrial (C&I) PPAs in connection with distributed generation projects. Newer PPA models (*e.g.*, physical and synthetic PPAs) have distinct advantages over these approaches, such as the ability to hedge large power loads in different regions and the “additionality” impact on a corporate procurer’s “green” initiative by supporting the development and financing of a new renewable energy project. While additional drivers of the recent corporate PPA trend — such as the extensions of the federal Production Tax Credit and Investment Tax Credits and declining prices for renewable power— have had a crucial influence on the industry, the common characteristics of certain corporate buyers have led to the shift in direct PPAs. These traits include creditworthiness, geographic diversity and heavy energy consumption, as well as the development of sophisticated procurement teams. Mr. Schultz also noted that corporate renewable PPAs, particularly wind PPAs, increased dramatically in 2015, and though that growth has slowed in 2016, solar PPAs are on the rise and the majority of *Fortune* 500 companies with sustainable procurement goals have not yet entered the corporate PPA market.

## Key Takeaways

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### PPA Structures

Ms. Hawkins introduced the next topic by reviewing the structures for traditional C&I and standard/physical PPAs that have been used by corporate off-takers to procure renewable energy. C&I PPAs, she noted, are fixed-price retail contracts involving the physical delivery of power to serve load demand at a specific location. The common challenges associated with renewable energy (e.g., geographic accessibility of renewable resources and intermittent supply) as well as limited regions that permit retail power sales have limited the proliferation of C&I PPAs.

Standard/physical PPAs also involve the physical delivery of power, but the power is not directly consumed by the corporate off-taker. The corporate off-taker takes title to the energy and resells the energy on a wholesale basis. Under this structure, the amount of power under the PPA is not tied to the load of the corporate off-taker, as the corporate off-taker continues to receive physical energy for its location from the local utility or retail supply partner. The resale of the renewable energy into the market acts as a hedge against the price of its energy consumption. However, the physical delivery of power associated with standard/physical PPAs is regulated under federal laws, which can increase the complexity and cost of these transactions.

Ms. Opadiran continued the discussion of PPA structures by providing an overview of synthetic PPAs and the additional flexibility they can provide. While the term “synthetic PPA” may be used to describe a financial transaction for the purchase and sale of renewable energy, the most common form of synthetic PPA uses a “contract for differences.” Under a “contract for differences,” a synthetic PPA is comprised of (i) a long-term financial hedge for the energy produced by a renewable project and (ii) a purchase-and-sale agreement for the associated RECs. Most notably, the buyer under a synthetic PPA does not take physical delivery of power. Under the “contract-for-differences” hedging structure, the corporate off-taker and the project owner reconcile the floating price payment received by the project owner for the power sold during a specific time period, with the fixed price to be paid by the buyer under the synthetic PPA. As a result, corporate buyers not only achieve their sustainability commitments of going “green” by providing additional renewable power to the market, but they also lock in cost savings if the actual energy prices increase over the life of the contract. This settlement process also results in a fixed-price contract for the project owner, which achieves its goal of stable cash flows.

Ms. Opadiran noted that a main driver in the growth of synthetic PPAs is the versatility that is afforded when the project and load can be located in different places. Aside from being concentrated in certain geographic regions, renewable energy projects typi-

cally require large tracts of land or rooftop space that are hard to obtain in metropolitan cities where corporate buyers are located, making the physical delivery of energy impractical and cost-inefficient. Synthetic PPAs, however, carry the risk of price exposure for the corporate off-taker if the market price for power where it is sold is less than the actual energy price paid by the corporate off-taker for the physical power it uses to satisfy its energy demands, or if the quantity of power generated by a project is more or less than a corporate buyer’s actual energy use. There are ways that strategy consultants and legal advisers can help to mitigate these risks, both in terms of structuring the contract and the procurement process.

### Contract Terms

The panelists continued the discussion of synthetic PPAs with an overview of the key “contract for differences” provisions in the PPA, including (i) delivery terms, (ii) supply and delivery obligations, (iii) purchase and sale obligations, (iv) credit support, (v) financing considerations and (vi) transfer restrictions.

- i. The long-term nature of synthetic PPA term contracts is driven by project developers’ need to lock in predictable revenues to secure financing, and corporate off-takers’ desire for fixed energy costs. Off-takers understand that the project’s ability to attract financing is key to their achieving “additionality.”
- ii. Milestones (e.g., commercial operation date) and termination rights are important for the corporate off-taker, as the corporate buyer doesn’t want to be bound under the PPA if the project is never built or if development is materially delayed.
- iii. The corporate off-takers purchase obligations relate to facility output and associated RECs, which creates predictable revenue to support project financing irrespective of actual load demand. However, if market prices fall below zero, the corporate off-taker may want to curtail generation as it does not want a negative price calculated into the floating price payment. Though the corporate off-taker may have the right to economic curtailment, this right could conflict with the seller’s preference to generate energy even at negative prices in order to receive production tax credits (PTCs), which are paid based on actual generation. Synthetic PPAs typically include a fixed price for RECs and a fixed price for energy, while recognizing that the seller receives the market price for energy as it is generated. The contract will refer to a specific settlement point, and both the market price at such settlement point and the fixed price for power will be used in the calculation of the floating price payment. If the seller, who receives the proceeds of the sale of energy into the market, receives more money in a month than the fixed contract price

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- for the same amount of energy during such month, the seller will pay the corporate buyer the difference as the floating price payment. If the seller receives less proceeds in a month, the corporate off-taker pays seller the difference. Capacity payments do not currently apply to renewable projects, but they may in the future, and therefore should be addressed in a PPA.
- iv. Credit support for the seller's obligations is important because the project owner is usually a special purpose vehicle with no assets other than the project itself. The amount of the credit support varies over the contract term, as there is often a step down once the project is fully constructed and operational, and performance risk decreases. Creditworthiness is critical for both the off-taker and seller and key to a financeable project, as any payment risk undercuts the value of the PPA as a revenue source for debt and equity investors. Unlike utilities who have strong balance sheets and investment grade ratings, corporate off-takers may need to provide credit support to backstop their payment obligations. That credit support may take the form of a payment guaranty by a creditworthy entity, a letter of credit, cash collateral or a combination of any of the three. If a payment guaranty is provided, then the PPA should include provisions that require another form of credit support if the guarantor suffers a ratings downgrade or other event that would impact the full force and effect of the guaranty. An off-taker may seek a lien on the project in addition to typical types of seller credit support (*e.g.*, payment guaranty by a creditworthy entity or a letter of credit from an acceptable bank). These liens are typically second in priority to any secured project financing, but they can provide additional value given that most projects will not be fully leveraged. However, they can add layers of complication to a deal because of the legal expertise and added cost, as well as the time, required to negotiate the security agreements and intercreditor arrangements with lenders and forbearance agreements with tax equity investors.
- v. Projected cash flows to be generated by a synthetic PPA need to cover the project's operating expenses and debt service, provide a sufficient buffer to meet any financial covenants in the financing documents (*e.g.*, the debt service coverage ratio) and achieve the target internal rate of return for tax equity investors. Given these considerations, the PPA term should be set to exceed the debt tenor or tax equity flip date by a few years in order to give flexibility if there is a force majeure or other construction delay. The panelists added that some of the points already discussed (*e.g.*, minimum purchase obligation, curtailment rights and credit support) are key terms that will be looked at by project lenders and tax equity investors to determine the stability of the PPA revenues.
- vi. Transfer restrictions take two forms, restrictions on assignment and on change in control. Assignments generally are prohibited under the terms of a PPA, with certain exceptions. Those exceptions typically include affiliate assignments (so long as the affiliate is creditworthy or the credit support is unimpaired) and assignments to experienced and creditworthy project developers. The latter is key to sellers because it can provide an exit strategy for their equity investors and can be facilitated by objectively defining "experienced" and "creditworthy" in the PPA. There is also a customary exception for collateral assignments to the project lenders and there may be an exception for assignments in connection with a sale leaseback tax equity arrangement (subject to certain requirements such as a non-disturbance agreement from the lessor). In regards to change in control restrictions, the panelists noted the importance for project developers to consider planned sell-downs or tax equity investments when negotiating the PPA in order to avoid needing the off-taker's consent at the time of sale. While this provision is important in any PPA, it is particularly crucial in corporate PPAs where an off-taker's inexperience with such transactions could create additional cost and delay. Change in control restrictions should have exceptions for sales of the ultimate parent of both the off-taker and the developer so that the PPA does not create issues for a larger transaction, and reiterate the importance of objective standards for "experienced" and "creditworthy," particularly for developers and off-takers seeking greater flexibility for potential change in control transactions.

### Additional Considerations

The panelists closed the webinar with their thoughts on additional considerations with respect to corporate PPAs, including the critical aspect of understanding and managing state and federal energy regulatory approvals. The Federal Energy Regulatory Commission (FERC) regulates interstate transmission of energy and wholesale sales of electricity. These considerations are particularly important to corporate buyers in physical PPAs who will be taking title to wholesale physical power, and depending on the structure of the PPA itself, may be subject to state regulation governing retail sales. In the context of synthetic PPAs, energy regulatory concerns are limited for the developer, however "contract for differences" hedging provisions may constitute derivatives under the purview of the Commodities and Futures Trading Commission (CFTC) and trigger additional administrative, recordkeeping and bookkeeping obligations for the off-taker and developer alike.

The speakers also shared their thoughts on an effective procurement strategy for corporations looking to sign a corporate PPA.

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The panelists suggested developing a green initiative in conjunction with strategy consultants knowledgeable in the renewable energy space. Corporate strategies should take into consideration energy use patterns to assist in reducing price, basis and consumption risks. Once a strategy is developed, requests for qualifications and proposals offer an opportunity for corporates to identify their requirements for the volumes of renewable energy they are looking to procure and the specific kinds of projects they wish to contract. As with other solicitations, corporates should specify their desired technologies, in-service dates, project locations, evaluation criteria and other bidder requirements, such as preference for a project in a particular location or a large, flagship project. The RFP also may include a term sheet that provides an overview of the indicative contract terms, or, more preferably, the form of PPA the corporate wants to execute. Once bids are received, a corporate can select one or more preferred bidders based on the evaluation criteria and can begin to negotiate the PPA. Given the unfamiliarity of most corporates with renewable energy procurement and the time and expense that can be associated with protracted negotiations, a developer may gain an advantage in the bidder process by minimizing comments to the indicative contract terms or form of PPA included in the RFP.