

## ITALIAN CPPAS – WHERE WE STAND

THE USE OF CORPORATE POWER PURCHASE AGREEMENTS IS GROWING IN ITALY THANKS TO AN INCREASINGLY FAVOURABLE REGULATORY FRAMEWORK. BY **EUGENIO TRANCHINO**, HEAD OF **WATSON FARLEY & WILLIAMS**, ITALY.

Power purchase agreements (PPAs) are contracts under which the owner of a power plant sells the power produced by the plant to an offtaker, for a pre-determined period at a pre-agreed price.

When PPAs are not entered into with wholesalers or traders that intend to re-sell the electricity to end-users but the offtaker is rather the corporate end-user of electricity, PPAs are defined as corporate PPA (CPPAs).

Like all PPAs, CPPAs allow producers to benefit from a constant, pre-determined cashflow, which is very important to ensure financial viability of subsidy-free renewable energy projects that typically suffer from high initial capital expenditure – for the design, construction, installation and testing phase – with relatively low maintenance costs. In other words, PPAs and CPPAs facilitate the bankability of green energy projects, providing the banks with the guarantees required for the granting of the necessary financing.

PPAs and CPPAs are beneficial to offtakers as well, as they can avoid, reduce or at least control the energy price volatility, negotiating appropriate pricing clauses with producers, ie fixed-price or variable-price with specific adjustment mechanisms.

Moreover, the supply of energy through CPPAs with renewable energy producers can play an important role from a corporate social responsibility perspective, contributing to the development of the green economy as well as the enhancement of the offtaker's reputation.

### The Italian regulatory framework

In Italy, there is no comprehensive body of legal provisions governing CPPAs, whose contents so far have been left for the most part to the parties involved to agree upon based on general principles of contractual freedom. However, the Italian government has recently moved towards regulating mechanisms to encourage the stipulation of long-term agreements for the purchase of green energy.

The starting point has been the approval of Italy's National Energy Strategy by Ministerial Decree of November 10 2017, whose purpose, along the lines of the long-term scenario drawn up in the EU's Energy Roadmap 2050, is to trace a path to sustainable growth of renewable energies, through strategic goals – eg, to guarantee security and stability to investors, enhance existing

infrastructures and assets and encourage process and governance innovation.

In this context, on July 4 2019, the Italian Ministry of Economic Development issued the so-called FER Decree, which, inter alia, aims to “promote, alongside traditional supporting schemes, mechanisms to encourage the sale and purchase of green energy through long-term contracts”.

Furthermore, Article 18 of the FER Decree provides for the launch of public consultations, in order to prepare a framework for the creation of a market platform that would act as a green energy supply-demand intermediary, through PPAs.

From this point of view, the Italian legislation is following the path traced by certain private international projects that have been developing digital applications for the offering, sourcing, screening and risk management of renewable CPPAs, eg the Instatruster platform by DNV GL.

### Typical contents of Italian CPPAs

Italian CPPAs generally include a number of recurring clauses, which can be summarised as follows.

- *Duration and termination* – Italian CPPAs generally have much shorter durations than in other jurisdictions, being normally taken out for short periods, ie 12 to 18 months, sometimes with the possibility of renewal. This is mainly due to the uncertainty of energy prices, which leads to low incentives for operators to bind themselves for long periods. Nevertheless, as a result of the FER Decree, an increase in the number of long-term CPPAs may be expected in the near future.
- *Pricing* – The price can be agreed as a fixed and invariable amount as well as a variable price, generally linked to the hourly zonal price as resulting from the day-ahead market Mercato del Giorno Prima (MGP), managed by GME.

Of course, fixed prices are better to avoid price volatility, but also imply a risk that, during the contract period, market prices substantially deviate from the contract price. On the other hand, when the variable-price solution is agreed upon, the off-taker's burden to get its supplies from the producer throughout the contract period must be offset by an economic advantage, ie generally a discount applied on each MWh purchased.

In accordance with EU Regulation 2017/2195, ARERA, by Resolution No. 310/2019 dated July 16 2019, asked to remove from the Italian markets

(MGP and MI - Mercato Infragiornaliero), effective from January 1 2021, the minimum floor of €0 per MWh that is currently in force.

Therefore, the Italian legislator is expected to introduce the applicability of negative prices to ensure greater flexibility in the event of temporary misalignments between energy supply and demand. Accordingly, recent CPPAs with effect over the aforementioned date are already being drafted by taking this change into account.

- *Change in law* – Change in law provisions generally include any change in EU, international, national or local law. In Italian CPPAs, possible future changes such as the introduction in Italy of a single national price replacing the zonal hourly price, or changes in the calculation of unbalancing costs, are excluded from the definition and allocated.

Other instances of unforeseeable changes are dealt with typically through the parties' obligation to discuss and mutually agree in good faith any adjustment necessary to restore the economic and contractual balance between the parties. In most cases, failure to reach an agreement will result in termination of the contract. Recourse to an independent expert with the power to redetermine the contents of the contract considering the change in law is less frequent.

- *Force majeure* – Force majeure clauses are usually drafted in line with international standards – ie, unforeseeable events beyond the control of the parties – and include, inter alia, terror attacks, war, revolutions, natural calamities, general or category strikes, actions of competent authorities, delays by the competent transmission system operator, etc.

- *Guarantees* – Corporate offtakers are generally required to secure their payment obligations by procuring an appropriate guarantee, ie typically a first demand bank or insurance guarantee, as a condition precedent to the effectiveness of the CPPAs or within a short period thereafter.

- *Bankability* – When a lending institution is involved, or is likely to be involved, typical bankability provisions will be included in Italian CPPAs, such as, for example:

- i) Exercise of discretions, eg termination, suspension rights, subject to lender's consent and prior notifications rights, to ensure stability of contract and the stream of revenues;

- ii) Step-in rights, assignability and pledgeability of CPPAs and receivables arising therefrom; and

- iii) Right to make unilateral amendments to contractual terms as reasonably requested by lenders and/or execution of a direct agreement.

Buy-side demand for Italian CPPAs

According to the latest official statistics available from Bloomberg NEF, published in the document 1H 2019 Corporate Energy Market Outlook, in 2018 CPPAs were stipulated for about 13.4GW of installed power in renewable sources worldwide. The most active region is the Americas with 9.1GW, whereas EMEA CPPAs stood at a value of 2.3GW. There are no reliable, official statistics for Italy yet but CPPAs represent a novelty, considering the first contract of this kind was signed as late as 2018.

In our experience, most Italian PPAs are utility PPAs, taken out by energy traders or wholesalers. Notwithstanding the above, buy-side demand for CPPAs is rising in prominence, also due to an increasingly friendlier Italian legal framework as inaugurated by Italy's 2017 National Energy Strategy and the FER Decree.

### Next challenges

The relatively low spread of CPPAs in Italy is closely linked to the structure of the Italian corporate market, which is mainly made up of small-to-medium enterprises (SMEs). According to Eurostat, in 2017 the electricity price for SMEs was €155.60 excluding VAT per MWh, not only the highest level in the EU, but also significantly higher than the price paid by large enterprises, ie €95.60 excluding VAT per MWh.

CPPAs could potentially enable SMEs to benefit from cheaper power than if they were to purchase electricity from a licensed wholesaler or trader. However, typically SMEs do not have the necessary financial means to cope with long-term contracts, and therefore the main challenge for Italy in this sector will be the introduction of mechanisms to facilitate the stipulation of CPPAs by SMEs.

The real turning point could be represented by the introduction of new contractual schemes, aiming to encourage demand aggregation for CPPAs. Indeed, Article 18 of the FER Decree provides that "buyers can participate in the platform in a single or associated form, or through aggregators".

In addition, to reduce transaction costs and make CPPAs more affordable to Italian SMEs, ARERA could be appointed to prepare long-term contract templates, thereby contributing to create a climate of greater confidence among less experienced end-users.

From a broader perspective, the World Business Council for Sustainable Development (WBCSD), in the public paper "How multi-technology PPA structures could help companies reduce risk", has highlighted that long-term CPPAs generally suffer from volume-risk, ie productivity variations across the contract period, such as higher than expected wind or lower solar irradiation levels.

The consequence is a low propensity to enter into long-term contracts as well as higher transaction costs for guarantees, technical due diligence etc. In conclusion, the paper suggests that a hybrid photovoltaic-wind CPPA can contribute to reduce these risks by alleviating both the volume-risk and the imbalance charges borne by the off-taker and/or the supplier.

In conclusion, the success of CPPAs in Italy must necessarily be achieved through a clear set of rules that are free from application uncertainties and capable of instilling confidence among players. For this reason, present and future measures that are currently under discussion based on Italy's National Energy Strategy, the FER Decree and ARERA's resolutions, will play a decisive role in the consolidation of the Italian market of CPPAs. ■