



PPA's and getting ahead of the energy transition

ESG voices podcast series

Musical intro

Announcer:

Hello and welcome to another episode of ESG voices! This podcast series addresses the opportunities and challenges within ESG, through interviews with ESG specialists from KPMG and beyond. Throughout this series, we will discuss a broad range of environmental, social and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future for all.

As companies consider their decarbonization strategies and their net zero ambitions they should aim to reduce their energy consumption and source higher amounts of low carbon or green energy. The recent energy crisis is also making companies reconsider their energy strategies — in terms of both consumption costs and the security of energy supplies. There are various renewable energy supply options available which all companies can consider. These include buying Renewable Obligation Certificates and Renewable Energy Guarantees of Origin. These will, however, have price premiums and their value can fluctuate according to market conditions and government targets. Companies can also generate their own renewable energy, but this is often not a realistic option as it can be expensive, will impact the balance sheet and will more often fulfill only a limited part of the energy needs. For companies looking for a secure long-term supply of renewable energy, Power Purchase Agreements or PPA's offer the most cost-effective method of sourcing large amounts of renewable energy, at competitive prices.

Today, I am joined by Marina Valls, Associate Director, KPMG in the UK and Nicolas Leonetti, Director, KPMG in France to discuss PPA's, how they can be used to support companies decarbonization strategies and why we have observed double digit annual growth of the PPA market during the last 10 years. Marina, to kick off our conversation, could you describe to our audience what a PPA is?

Marina:

Sure, so a PPA is a power purchase agreement and it's ultimately a long-term bilateral agreement between an energy producer, so generator and a consumer. In the

case of corporate PPA's, which is what we're going to be talking about today mainly, the consumer is actually a corporate organization and, in their case, PPA's are a form for that organization to procure power, and more specifically procure low carbon power by purchasing it directly from the source at a pre-negotiated price.

Announcer:

And Nicolas, can I get your thoughts?

Nicolas:

And maybe to add on what Marina just said, there are different types of PPA's that corporates can contract. First of all the most simple one for corporates to start with is the onsite PPA. So, in that case, the corporate will leverage surfaces that it obtains, it can be roofs or it can be backing loads, or it can be land and it will have an agreement with the developer for the developer to install renewable assets on that sort of phase, produce electricity and sell back the electricity which is produced. So, it's slightly more simple because there is no question of looking for some land it already exists within the cooperate. The type of PPA or offsite PPA, so in the case of an offsite, PPA, the developer will look for lands obtain all permits necessary to use the lands to install the assets either windmills or solar panels and then similarly to the onsite PPA will produce electricity and sell the electricity produced to the corporates at conditions which are pre-agreed between the parties.

Announcer:

Thanks Nicolas. Marina what are the expected benefits of PPA's and why are PPA's valuable to organizations?

Marina:

There are quite a few reasons and ultimately those reasons will be different depending on what/who the organization is and where it is located. But in general and based on the definition that Nicolas just gave. There are two main axes. The first one is around decarbonization. It allows you to secure for long term periods, clean power, and therefore to be able to claim that the power that you use for your everyday consumption as an organization is carbon free, which is quite important today for a lot of organizations that have climate targets, and science based targets that they're

hoping to achieve. In particular, PPAs can offer something that we call additionality. And it's something that is very sought after these days in the market because it's basically the ability to demonstrate that thanks to your contract in your consumption, you have allowed the development of a new renewable asset into an energy market or energy grid. Without the corporate signing this agreement and without the corporate procuring clean power, there wouldn't be a new asset generating clean power into an energy grid. So that's a really valuable argument for any organization that is hoping to decarbonize and demonstrate that they are meeting those targets. The second angle, is around price. And so, I said that earlier that you have pre-negotiated price as part of this long-term agreement. So very obvious benefit to organizations is that it gives you that long term visibility and certainty on price. You have seen recently that obviously, energy markets have been very volatile in the cost of even the wholesale but also retail prices has gone up. While it might go down over the next couple of years, it might still go up. We're not protected against potential, geopolitical crisis or any crisis that might impact energy prices. The corporate PPA allows you to negotiate a fixed price and therefore be a little bit more resilient to those variations in the market, which is very important for a lot of organizations that we talk to.

Announcer:

Thanks Marina. Nicolas, how can PPAs support organizations decarbonization strategies?

Nicolas:

Yeah it is an interesting question. Maybe one step back to look at what a company needs to do in order to build a complete exhaustive decarbonization strategy. You need to look at the three scopes one, two and three of decarbonization. Scope one is related to the direct emissions of corporates. Scope two are emissions in particular, related to the purchase of electricity and scope three are emissions which are related to external partners or stakeholders, suppliers, distributors, etc. So, when it comes to PPA, it impacts specifically scope two because scope two addresses the carbon content of the electricity purchased. And so here in terms of strategy that the corporates can build, I spoke earlier about different types of PPA, so a company will look at whatever volume of electricity they can source first, onsite PPA, which is probably the easiest one to activate initially, but it's to be limited to a certain volume of electricity. So for example, source five to 20 percent of the electricity through onsite PPA, then they will look at offsite PPA to get larger volume of electricity source, so PPA clean energy, decarbonized energy and they could maybe go up to 70 percent of energy source through this lever. And ultimately, but after those two levers are used they can look at complementing other markets through the purchase of recs, for example. So that's how it should be viewed. The fact that it's quite a change in energy sourcing strategy, they have to consider in fact a portfolio of different types of contracts. In order to be able to fully decarbonize scope two of their emissions. Also one interesting thing to look at, which is maybe less common is looking at scope three and particularly for large

corporates who have also large ecosystems of suppliers or distributors. They can also support them negotiating PPAs so they can make some improvements of companies in order to have the critical size and negotiate/push the partners to negotiate large PPAs to also decarbonize. So doing this, suppliers, or partners will decarbonize their scope two and will also contribute to the decarbonization of scope three of the corporates.

Announcer:

That's great Nicolas, thanks. Marina, if organizations are looking into PPAs to help support their decarbonization journey, where should they start?

Marina:

So the first step is always to try to look inside and understand your own needs. PPAs as attractive as they may sound might not be suited for every organization, or more importantly, they might not even be available fully in every market. At the same time, Nicolas has just mentioned that there are different types of PPAs mainly, so the distinction between the onsite and the offsite, and those different types of PPAs might not be suited for every organization. An organization with obviously a lot of land might go for a lot more of onsite PPA than an organization with only a few office blocks in a city, for example, so that is very important. Taking the time to understand your actual needs, your energy needs, your current contracting process, but also your future growth and ambitions as an organization. Where do you want to take your consumption levels? Which markets you might decide to grow into? Understand all this and compare that to what is actually available from a technology regulation, market perspective in the country that you're based in, is the first step and this is a lot of the work we do as part of our initial phase of work with our clients when they come to us.

Announcer:

And Nicolas, would you add anything?

Nicolas:

Another very important point to look at is internally. So PPAs are very complex contracts, those contracts impact many functions in the company, purchasing sustainable industry or finance, accounting, legal. So it's very important that all those internal stakeholders clearly understand the stakes, the opportunities, the risks associated to those contracts. So then really be onboarded into program so that they can support the program and when we are in the position to negotiate and sign the PPA everybody in the company will be aware about what is being done. What are the benefits that will be obtained from such contracts without the risks that need to be managed, etc. So that's very important that all key stakeholders are really well educated about the specifics of PPAs.

Announcer:

What are the lessons you have learned from previous engagement and what advice would you give based on those lessons? Marina can I come to your first?

Marina:

There's quite a few lessons, I think, maybe the first one I would think about is the fact that contracting a PPA, so a completely bilateral contract between two parties is something that is going to potentially be very attractive, but also takes quite a lot of time. So you have to be ready for longer procurement process and negotiation periods in which you decide what works best for the two parties. During that process, making sure that you establish trust with the right partner and the sort of the developer in the case of a corporate that you have in front of you is very, very important. So ensuring that you can manage that relationship while you are negotiating and ensuring that they keep sort of coming back to you and that everybody negotiates in good faith is quite important. We've seen some cases where negotiations fall through and you have to start all over again. So it's very important that sort of you've kept an open discussion with everybody in the market and that you come in with a good, a good will, let's say in terms of how you want to take the discussion forward. The second element which is also linked to that is that PPAs are in a lot of demand these days from organizations. So it's quite important to make sure that you are seen as a potential and attractive partner and that you are ready to motivate the counterparty into why they should engage with you and not another corporate. So ensuring that you have a process that is attractive enough to get interesting conversations going, competition going is really the difference between a successful process and a failed process and one of the keys to achieve that is to talk to the market.

So a lot of what we do with our clients is initially a lot of market soundings, ensuring that we shortlist the right partners for them and that there's very much of a potential in a partnership, you're not just contracting with anyone you're contracting with someone that could be a trusted partner for long term.

Announcer:

And Nicolas?

Nicolas:

Maybe to add to what has just been said, I think it's really important to understand that PPAs are not at all standard purchasing contracts because they are very long term, we are speaking about five to 20 years. So it's very much longer than most of the contracts that the companies used to sign. And the stakes are also very big. It can be 10s or hundreds of millions of Euro for the total duration of the contract. So it means that it's important to understand the stakes, to understand the balance between the offer and demand. So the fact that developers obviously own interests that needs to be taken into consideration in the negotiation and the balance of power between the buyer and the seller can really change a lot compared to what again corporates are used to see on the markets usually. And so it's important to really adapt the negotiation strategy. For example, we have been in contact with corporates recently who you used to organize auctions to sell it to your supplier but what we see also on the market is that now the developers that tend to organize themselves options to select the client, so we

can see that yeah, it's very specific market, and it's really important to take time to, to have a deep understanding of the dynamics of that market.

Announcer:

Marina, to wrap up our conversation today, in your opinion what does the future hold for PPAs?

Marina:

The main thing we're seeing is expansion of the geographies that allow and that have made PPAs possible. So we've seen quite a lot of the emerging markets as we would normally call them, really getting into that sort of PPA period in a way and by sort of ensuring that the regulation is adapted, so that those bilateral contracts can be signed more and more. So I'm thinking particularly we've got sort of quite a lot of Asian markets that are emerging, not a lot of PPAs had been signed, but it's something where we now actually are able to sit around the table and have conversations about potential future long term PPAs whether that is onsite or offsite or different types of PPAs that we've talked about in this podcast. We're starting to see a lot of interest. So my view is that they're just going to not stop to the markets where they currently are, there's going to be a massive geographical expansion of where those contracts can be signed and hopefully, that will allow as well to democratize the process a little bit. So having not just new, larger organization with big consumption in one specific country that can effectively access that market and sort of really leverage that consumption with bilateral contracts with developers but maybe organizations with a larger footprint, but maybe smaller in some countries that can have cross border engagements, or even sort of unite with other organizations to go to market as one and try to have to be more attractive to developers. So I think yeah, an increase in the amount of markets where you can sign PPAs and definitely I think an increase in in the type of smaller or medium size of organizations that we might see also sign PPAs over the next two years, hopefully, is what I'm expecting to see.

Announcer:

And Nicolas, can I come to you now?

Nicolas:

Yeah. Also, I think we said several times that PPAs is complex contract. Fact it's complex, because it's, again, very long contract. So you need to take a lot of attention to the different terms of the contract. What happens is another party wants to terminate before the end? What happens if there is a change in law or change in regulation that will affect the economic conditions of the contracts? Also, there are complexities around accounting topics, especially we didn't speak about that. But there is a type of PPA which is a virtual PPA, which is more of a financial edging instrument. So we've got quite complex things to look at in order to really understand the impact of such contract and to report it in the balance sheets and PNL. Also when implementing physical PPAs you also need to source some additional aggregation services from

possibly a third party. So I think going forward what will accelerate the deployment of those PPA's or standardization or simplification of a number of conditions, it can be more standard contractual terms, it can be an evolution of some accounting rules in order to create a more favourable environment for the development of PPA's and also probably the developers and the largest one will tend to offer larger scope of services in order to really support the client in all the, I would say, concrete activities to implement the contracts. So that's to really we believe things will move in that direction, to make the market more fluids and more easy for the corporates to look at.

Announcer:

Marine and Nicolas, thanks again for speaking today, you've given our listeners a lot to think about! Join us again next time for more insights from ESG leaders and innovators. You can also find our latest insights covering a range of ESG topics by visiting kpmg.com/ESG.

Thanks for listening!

Musical exit

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