FINDING MONEY FOR RES

SENIOR ASSOCIATES AT DENTONS BANKING AND FINANCE PRACTICE, **JUSTYNA JAMROŻY** AND **MARCIN GRUSZKA**, WRITE ABOUT THE NEW SOURCES OF FINANCING INVESTMENTS IN RENEWABLE ENERGY SOURCES.

Poland is one of the fastest growing renewable energy markets in Europe. The country has committed itself, according to EU law and the Energy Policy of Poland until 2040 (EPP2040), to increase the share of renewable sources in its energy mix. More generally, the consequences of the Russian invasion of Ukraine and related actions and sanctions have generated additional pressure across the whole of the EU as energy prices have skyrocketed in all markets and fears for energy security have been substantiated. Moreover, many entities, especially corporates, are looking for options to reduce their carbon footprint due to the upcoming Environment, Social and Corporate Governance requirements, and increase their interest in green and sustainable financing.

CONTRACTS FOR DIFFERENCE

In Poland, the renewable energy market has been growing mainly in the solar department, with some investors starting large-scale projects that exceed 100 megawatt. The dominance of the solar portion of the renewable energy market stems from the fact that onshore wind farm development was virtually brought to a halt in 2016 because of a rule on the required minimum distance to the nearest residential housing, which set it at 10 times the wind turbine's height.

The reason why the investment in renewable energy has been on the rise in Poland is the 2016 implementation of the auctioning scheme—based on the principle of the contract for difference (CFD). The Polish energy market regulatory office (URE) auctions energy volumes as inflation-indexed, 15-year CFDs. Depending on a bidder's awarded bid price and the base index market price, the bidder is paid the difference—the so-called negative balance—on a monthly basis. If the base index market price exceeds the bid price and thus is in positive balance, this will be settled against a future negative balance, which the bidder repays at the end of each three-year settlement period.

CFD is basic support mechanism for renewable energy sources (RES). It helps investors obtain external financing because it is stable and predictable with fixed period, standardized terms for all projects, guaranteeing foreseeable income stream with inflation-indexed price and low termination risk.

However, the recent spikes in energy prices at the Polish power exchange have made investors interested in long-term corporate power purchase agreements (PPAs), which also provide stable revenue streams for investment projects. Just as CFDs, PPAs also offer interesting route-to-market opportunities for investors. Recently the role of the PPA support scheme as compared to the CFD has

Investments in solar energy sources dominate the renewable energy market in Poland.

started to grow and it might become a dominant model for financing new investments in the Polish renewable energy.

BANKABILITY

Under a PPA an entity (PPA off-taker) agrees to buy electricity from a producer for a fixed term and fixed price or a price decided by the price-netting mechanism — the latter entity usually being a special purpose vehicle (SPV) undertaking a renewable energy project. It is worth noting that apart from PPAs providing for the physical delivery of renewable energy there are also agreements called "virtual" or "financial" PPAs without such element. These contracts are financial instruments in which parties agree on a strike price. Depending on the difference between the sale price of energy on the wholesale market from the given installation and the strike price, respective cashflow exchanges are made between the parties.

Financial institutions willing to provide financing based solely on a PPA revenue stream would carefully review certain aspects of the contract to assess the project's bankability and credit risks. Above all, scrutinized are provisions affecting the cash-flow to be generated by the project, including any provisions regarding the agreed energy price, such as calculation and payment dates, but also payments to be made by the producer towards PPA off-taker, duration of the PPA, the type of the contract's base-load or "as-produced", and the conditions under which any party may terminate the contract.

Evidently, the creditworthiness of a PPA off-taker is a crucial issue for PPA based financing. It is often evaluated not only based on the financial standing of the PPA off-taker itself, but also from the perspective of having a financially strong parent company able to provide a corporate guarantee. All these factors are relevant to ensure a stable, predictable and long-term revenue stream, such that would make the SPV to timely service its debt that has arisen from the financing provided by the financial institution.

The financial institution also has to make sure that sufficient security has been established in connection with the PPA. The scope of the security may vary depending on the project, but from our experience it is clear to see that financial institutions most often require a security assignment of rights and claims of the SPV under the PPA together with security established by the parent company of the PPA off-taker. Thus all rights and claims of the SPV thereunder need to be assignable toward a financial institution without an obligation to obtain consent or any other restrictions, and preferably to have Polish law govern the PPA.

DIRECT AGREEMENTS

A direct agreement with a PPA off-taker is also quite a standard. Usually, it is a three-party agreement between the financial institution, the SPV (being a borrower) and the PPA off-taker. Under such an agreement the PPA off-taker makes certain obligations directly in favor of a financial institution. These include, in particular, sending prior notice to the financial institution before PPA termination, a step-in right in case SPV does not perform its obligations under the PPA, and obligation to make payments under the PPA to project accounts of the SPV. Thus, it would be advisable for a potential investor to state in the PPA that the PPA off-taker would not refuse to enter into a direct agreement with the financial institution, preferably providing certain standard terms of the direct agreement. We note in our transactional practice that negotiations with PPA off-takers may be difficult. Often, direct agreements are the last finance documents to be agreed upon in the financing process.

The above mentioned elements, which make a PPA and, hence, renewable energy project bankable, will also be reflected in the financing agreement and other relevant finance documents. To this end, there are provisions protecting cashflow that provide for the waterfall of payments and structure of the SPV accounts and impose restrictions that limit the SPV's rights to amend or terminate the PPA, make a new PPA or engage a new acceptable PPA off-taker. In addition, any defaults under the PPA and any circumstances affecting the validity and enforceability of the PPA, the ability of the PPA off-taker to perform its obligations under the PPA, and the financial standing of the PPA off-taker would be treated equally as breach of the financing agreement, with limited remedy rights, if any, on the SPV's side.

SUMMARY

It is evident that the shift from financing based on the CfD support towards financing based on a PPA has become an attractive model, and that will help supporting Poland's transition to green energy.

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