

To: European Commission, DG ENER and DG COMP

Nordenergi views on how to improve the flexibility of market-based Power Purchase Agreements (PPAs) to support European competitiveness

1. Background

A PPA is a tailored, market based agreement for the supply of power at an agreed price over a given period. As a rule, the agreement is entered into between a power producer and a consumer, and can often have a long horizon (10-15 years). There are many different forms of PPAs. They can for example be physical or financial (also called virtual) and baseload or pay as produced. Also, a PPA can be based on an existing portfolio of assets (typically hydro, nuclear, solar or wind) or they can be used to finance the build-out of new assets, so-called corporate PPAs. What they have in common is that the PPA agreement is subject to lengthy negotiations to identify counterparty risk and find agreement on price. The use of PPAs is widely considered an effective way to reduce financing costs of generators and to mitigate the impact of short-term market fluctuations on electricity prices paid by the consumers, including industrial consumers.

In some countries, regulatory barriers are hampering PPAs at the national level, such as obstacles to the signing of direct contracts between generators and off-takers. In the Nordic countries on the other hand, the bilateral market for PPAs and other forward contracts is generally working well, although there may remain some administrative obstacles in individual countries. An essential feature is the actual demand for the electricity behind PPAs as they are contracts between two counterparties.

2. Views on PPA flexibility

In the context of the Draghi report, the forthcoming Commission Guidance document on combining CfDs and PPAs, the upcoming Industry Decarbonisation Act, the planned new Clean Industrial State Aid Framework (CISAF) and measures for security of supply, Nordenergi would like to highlight the following principles with regard to the key issue of how to increase availability of PPAs and flexibility:

General views

1. PPAs are and must remain market-based agreements based on price expectations in the electricity market during the contract period. They do not require public support.
2. The ability of market participants to tailor PPAs is a particularly important asset.

3. PPAs should, as a rule, not be harmonised or standardized as they based on negotiations are adjusted to technology and risk profiles on both the buyer and seller side.
4. We believe that the best way to support industry subject to competition on the world-market is through direct targeted lump sum support. This could be in the form of state aid, financial guarantees to reduce counter-party risk, or faster depreciation rates. However, any support that leads to uneven competition should be considered very carefully.
5. In our view it is important to avoid interventions in the internal electricity market which would distort price formation and contractual market-based arrangements.
6. On a general note, we are concerned that other state aid measures could lead to reduced demand for commercial PPAs due to expectations of potential subsidies that the different proposals envisage.
7. We want to emphasize that proposals to use PPAs for subsidy purposes lead to unpredictability and may reduce the number of PPAs being entered into.
8. We continue to be positive to the removal of barriers to PPAs, and a mapping of such obstacles may be useful as a first step.

Views on aggregation of demand and/or supply

9. In a 'Green Pool' scheme, it is proposed that "shaping costs" will be covered by public subsidies or consumers through a separate fee. We do not support any form of mandatory aggregation of demand and/or supply in a "pool". This will undermine tailoring and reduce efficiency in the market. Requirements to participate in a pool is likely to be unattractive for the seller and indirectly undermine the availability of PPAs for industry. Voluntary private aggregation on market terms, on the other hand, can be positive but these are arrangements that are complex to enter and administratively burdensome to follow up.
10. We are generally negative about the term "shaping costs". These costs are a natural part of a power system. They reflect the value of electricity, for the producer as well as the consumer, and are not a "problem" that should be solved by market intervention.
11. Thus, government support should not be introduced to reduce "shaping costs". Pricing them provides incentives to develop flexibility solutions. In the longer term, "shaping costs" can be reduced by increasing the degree of flexibility in the power system through energy storage systems and demand flexibility. This must mainly be incentivized through prices in the market.
12. Arrangements to remove short term price signals represent a significant market intervention that will weaken the incentives to enter long term contracts both through PPAs and financial hedging. It will also distort the price signals for renewable energy and reduce the incentive to develop additional flexibility.

13. We find that linking support for flexibility on the industry side to PPAs as outlined by DG COMP runs the risk of severely interfering with PPA markets. It is unclear to us how an auction mechanism would work from the selling side and how it would reflect the LCOE of new clean flexibility capacities.

Other flexibility issues

14. Adding requirements such as additionality, hourly and geographical correlation to PPAs would clearly limit the supply of clean flexibility and lead to higher prices. On this basis, we don't see it as realistic or efficient way to enhance industrial electrification.
15. Incentives to increase flexible consumption and production (e.g. not produce at negative prices) are now being incorporated in new PPA designs. The shaping costs are lowered if some flexibility is incorporated in the agreement. This is good news for the electricity market, as it ensures that more production and consumption react to price signals (even when they are based on PPAs) while still getting some price stability.
16. The additionality requirement (such as the RNFBO requirements), which only allows the conclusion of "clean PPAs" with "new installations", artificially limits supply by excluding existing flexible resources, such as hydropower, and thus risks contributing to higher prices.
17. Similarly, the requirement of temporal and geographical correlation further limits access and prevents industry from benefiting from the interconnected European power market
18. Providing industry with a financial contribution to cover costs of reducing consumption of CO2 intensive electricity, of storing electricity or of investing into additional reliable low-carbon renewables should be done through direct support.
19. It is unclear to us how an auction mechanism would work from the selling side and how it would reflect the LCOE of new clean flexibility capacities.
20. We do not see the benefit of introduction of what has been called an "Electron Bank" if the aim is to cover a "clean flexible premium", being the difference between the PPA price and the industry bid price. This would distort markets, reduce incentives for demand response and constitute indirect support to industry instead of supporting directly. We do not agree that an Electron Bank would improve long term clean flexibility price signals compared to tailor made PPAs.
21. We support the proposed Industrial Decarbonisation Bank, which directly supports the decarbonisation/electrification of industry and the proposal to use EIB counter-guarantees.

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Nordenergi would like to recall that a well-functioning bilateral market for PPAs and other forward contracts can contribute to reduce the price effect of market fluctuations. We remain available for further discussions if this is useful for you.

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Nordenergi is the joint collaboration between the Nordic associations for electricity producers, suppliers and distributors. Members are Swedenergy, Green Power Denmark, Renewable Norway, Finnish Energy and Samorka. Overall, Nordenergi represents more than 2,000 market actors (member companies), most of them active in the electricity sector, but also in other areas such as district heating, gas and services. For more information regarding Nordenergi please visit www.nordenergi.eu. EU Transparency register number: 85161125283-02.

