



DEWEY & LeBOEUF

South Africa's Renewables Programme – Latest
Developments and the Way Forward

Renewable Energy Africa Conference

Johannesburg

July 2011

Scott Brodsky
Dewey & LeBoeuf
Johannesburg

Tel: +27 11 911 4303

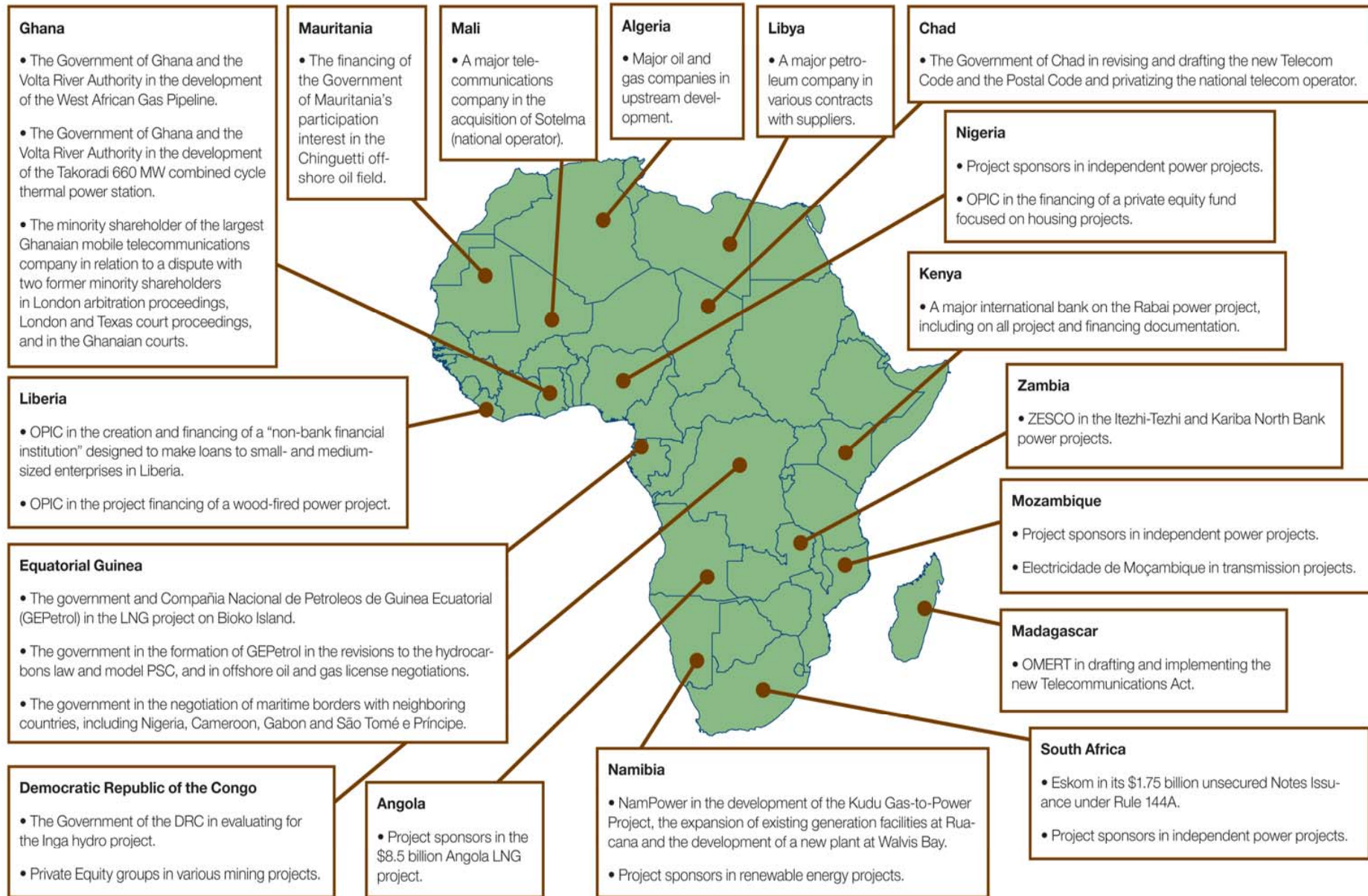
Email: scott.brodsky@dl.com

Dewey & LeBoeuf LLP
dl.com

Outline

- South Africa's Power Generation and Needs
- South Africa's REFIT Programme – Key Features and Recent Developments
- Latest Developments
- Other Key Issues
- The Way Forward
- REFIT's Potential for the Economy
- Questions

Dewey & LeBoeuf in Africa



South Africa's Power Generation – A Snapshot

- Eskom dominates generation:
 - It generates 2/3 of Africa's electricity
 - It generates 95% of SA's electricity
 - It also imports and exports regionally e.g. from Cahora Bassa hydro project in Mozambique
- Current generation capacity approximately 40,000 MW
- 70% access to electricity, compared to SADC average of 20%
- Almost 90% of generation is coal, remainder nuclear and hydro/pumped storage
- Currently almost no renewable generation

South Africa's Generation Needs

- Economy is energy intensive – mining, pulp and paper, smelting
- Widespread load shedding occurred in 2007 and 2008, culminating in closure of mines for one week in January 2008
- Reserve margins extremely tight in coming years and load shedding expected to return
- 10,000 MW of current 40,000 MW expected to be retired in next 20 years
- Eskom estimates that 50,000 MW of new generation capacity needed in next 20 years
- Private power and renewable power expected to play a significant role in new generation
- Rapid deployment of renewables essential to keeping the lights on
- IRP 2010 targets 42% of new generation capacity from renewables

South Africa's REFIT Programme – Key Features

- White Paper on Renewable Energy – November 2003 – set 10,000 GWh annual target by 2013
- Programme really started taking shape in 2009
- Tariffs published in 2009 for nine technologies, including wind, CSP with and without storage, PV, Biomass and Biogas
- Concentrating PV excluded on grounds of cost
- Co-generation excluded but COFIT Consultation Paper now published by NERSA
- Draft PPA and Selection Criteria have been published and NERSA has carried out extensive public consultations
- March 2009 Guidelines had suggested a “first come, first served” approach but (now repealed) 2009 Regulations and draft selection criteria make it clear that selection will involve a tender and competition based on criteria

South Africa's REFIT Programme – Recent Developments

- 27 September 2010 – DoE publication of Request for Information (RFI)
 - sought information from developers of co-generation and REFIT projects up to March 2016
 - intention to allocate dedicated REFIT MW to small projects (1-5 MW)
 - Indication of likelihood of requirement/preference for projects using local materials, labour, manufacturing and maintenance
 - Responding to RFI not compulsory
 - 384 responses for 20,000 MW of REFIT and 4,000 MW of cogeneration
 - In capacity terms, 70% wind, 15% PV, 10% CSP
 - “Readiness Index” indicated few projects ready to go

South Africa's REFIT Programme – Recent Developments (cont)

- 27 September 2010 – DoE publication of TOR for appointment of numerous additional consultants to advise Government
 - Government decided to appoint additional legal advisers, as well as financial, technical, BEE, environmental, local energy expert, and communication specialist advisers
 - advisers to assist in finalising programme and related documentation
 - Indicated timing extremely ambitious
 - Advisory team appointed late 2010 to finalise documentation for launch

South Africa's REFIT Programme – Recent Developments (cont)

- 27 January 2011 - Publication of NERSA Consultation Paper on COFIT
 - Includes tariffs for waste heat, bagasse and other cogeneration technologies excluded from REFIT
 - Written public comments invited by 25 February
 - Public hearings took place on 5 May
 - Approval of rules and tariffs delayed from 26 May
 - Early days but tariffs positively received
 - Contemplates minimum 15 years generation licence and minimum one year PPA based on MTPPP
 - 2000 MW contemplated by 2020
 - Positive next step as follow on from REFIT

South Africa's REFIT Programme – Latest Developments

- Capacity up
- Rollout plans accelerated
- Tariffs down ?
- Fresh uncertainty – REFIT, price competition, or hybrid?
- Clarity and alignment needed
- Timing and next steps

South Africa's REFIT Programme – Latest Developments

- Capacity Up
 - Final IRP 2010 published 29 March; promulgated 6 May
 - IRP 2010 sets out 20 year plan for generation
 - Renewables percentage of new build generation capacity up from 30% in draft IRP 2010 to 42% (equates to approximately 9% of energy produced)
 - Equates to additional 17,800 MW of new renewable generation (on top of 1025 MW previously committed), broken down as:
 - ◆ 8,400 MW PV
 - ◆ 8,400 MW Wind
 - ◆ 1,000 MW CSP
- Rollout Plans Accelerated Significantly
- IRP is a “living plan” – will be revised every two years from 2012

South Africa's REFIT Programme – Latest Developments

- Tariffs Down ?
 - 22 March NERSA published Consultation Paper for REFIT Tariff Review
 - Proposed changes would have triple impact:
 - ◆ Timing: Lower tariffs would apply to all REFIT projects, and not just to projects completed from 2014
 - ◆ Tariff levels: substantially reduced
 - ◆ Indexation would apply only to O&M element of tariff, rather than entire tariff
 - If effected, these changes will impact the economics of all projects and the viability of many
 - Investors participated actively in consultation process

South Africa's REFIT Programme – Latest Developments

- Extensive industry comments generally consistent and included
 - Tariff adjustments should not undermine investor confidence or discourage investment
 - Importance of predictability, certainty and stability
 - REFIT brings ancillary benefits e.g. BEE, industry development, job creation
 - Developers have spent significant sums preparing projects given anticipated “first mover advantage” and on the basis that published tariffs would apply to initial projects
 - Tariff levels have influenced project developments e.g. site and supplier selection
 - Revised tariffs should apply only from 2014
 - Importance of being able to make a positive statement at COP 17
 - Proposed tariff reductions and reduced indexation do not achieve 17% proposed return

REFIT – 2009 and 2011 rates

RE technology	2009 REFIT (ZAR/kWh)	2011 REFIT (ZAR/kWh)	% Change (excluding inflation)
Landfill gas	0.65	0.539	-17.1
Small hydro (less than 10 MW)	0.94	0.671	-28.6
Wind	1.25	0.938	-24.9
Concentrated solar power (CSP) trough with Storage (6 hours)	3.14	1.836	-41.5
Concentrated solar power (CSP) trough without storage	2.09	1.938	-7.3
Solid Biomass	1.18	1.060	-10.1
Biogas	0.96	0.837	-12.9
PV (large ground or roof mounted)	3.94	2.311	-41.3
Concentrating PV – no tariff published on grounds of cost	N/A	N/A	
Concentrated solar power (central tower) with storage	2.31	1.399	-39.4

South Africa's REFIT Programme – Latest Developments

- New Generation Regulations originally promulgated in August 2009 specifically contemplated REFIT and made NERSA responsible for determining REFIT tariffs and selection criteria
- Draft replacement Regulations published for public comment on 30 November 2010 made substantial changes but also referred expressly to REFIT programme
- Replacement Regulations Gazetted 4 May 2011 repeal 2009 Regulations
- 2011 Regulations no longer expressly contemplate a REFIT programme
- Intention/implications unclear at the time but this added to uncertainty and heightened investor concerns on Regulatory risk

South Africa's REFIT Programme – Latest Developments

- 26 May Minister of Energy statements in Press Briefing and Budget Speech:
 - “...I am delighted to announce that preparation of procurement documentation under Renewable Energy Feed in Tariff (REFIT) has been completed...By December 2011 we would have completed the procurement process under the REFIT programme as committed and announced by the National Energy Regulator of South Africa (NERSA) in 2009. We do confirm that the outcome of the current revision of these tariffs by NERSA will only affect the second phase of renewable procurement...” (from Press Briefing)

South Africa's REFIT Programme – Latest Developments

- “The Renewable Energy Feed-in Tariff (REFIT) procurement process is a starting point in implementing the IRP...” (from Budget Speech)
- These statements seemed a strong confirmation of REFIT
- Minister also stated:
 - “...the procurement of solar photovoltaic, concentrating solar power, biomass and other technologies will take into consideration the legal requirements relating to public sector procurement, in terms of which procurement is required to be open, fair, transparent, cost effective and competitive” (from Budget Speech)
- These requirements are in Constitution and other legislation and are not inconsistent with REFIT, which has been structured as a competitive procurement process
- But then in June...

South Africa's REFIT Programme – Latest Developments



South Africa's REFIT Programme – Latest Developments

- Article quotes DDG of DoE
 - “We’re definitely going to have price competition on the different technologies.”
- DoE intention confirmed by DG on 5 July
 - Indication that 2009 REFIT rates will be a ceiling
 - Indication of two-stage process:
 - (1) Minimum requirements for localisation and other criteria
 - (2) “If you cannot meet localisation and job creation requirements, we will not even look at the price”
- Weight to be given to price not clear

South Africa's REFIT Programme – Latest Developments

PPPFA

- Where PPPFA applies, requires procurement weighting “90/10” or “80/20” in favour of price
- Historically act has not applied to Eskom
- Minister of Finance may exempt application of Act on specified grounds
- 8 June: Gazetting of Notice extending application of Act to include Eskom w.e.f. 7 December 2011
- 8 June: Gazetting of new Regulations under Act, which will also take effect on 7 December 2011
- Will renewables procurement start before changes take effect on 7 December? Will application of Act be exempted in order to bring other criteria into selection process?

South Africa's REFIT Programme – Latest Developments

PPPFA (cont)

- New Regulations:
 - Contain “90/10” formula for price/BBBEE weighting (Note: formula is not as simple as 90/10 comparison)
 - Formula assumes that there will only be one successful tenderer – renewables programme contemplates multiple successful projects
 - Require tenderers to submit BBBEE certification
 - Allow DTI to designate an industry sector with compulsory minimum local content requirements (Note: renewables is not currently a designated sector)
 - Where industry sector is not designated, procurer may include local content requirements in tender if in accordance with specific directives issued by NT in consultation with DTI
 - Allow two stage process: local content first, followed by application of 90/10 formula and possible price negotiations

South Africa's REFIT Programme – Latest Developments

- Clarity and alignment needed quickly
 - IPPs in South Africa have been through a number of false starts
 - Investors – whether South African or international – can only be asked to continue to spend time and money for so long
 - There are numerous markets competing for investor interest and funding
 - Regardless of final result, these latest developments have created uncertainty and heightened regulatory risk concerns
 - The problem will be exacerbated the longer the uncertainty continues
 - Official clarification and detail awaited

South Africa's REFIT Programme – Timing and Next Steps

- Latest DoE indication is that launch is imminent
- NERSA announced delay in approval of revised tariffs from originally indicated 26 May date – will revised tariffs still be published?
- NERSA needs to concur with Minister of Energy's determination
- Press reports earlier this month suggested that NERSA was set to concur with price tendering but had raised questions
- 22 July DoE indicated that it had prepared a response to NERSA's questions
- DoE further indicated that it expected to receive NERSA's full concurrence this week to enable the RFP to be issued and procurement process to start

South Africa's REFIT Programme – Timing and Next Steps

- Initial procurement expected to be for up to 3825 MW for projects reaching COD by 2016
- Once procurement starts, it is expected to continue on a rolling basis until targets reached – 5 bidding “windows” expected
- Bidders conference expected to be held one month after RFP launch
- Initial bid period may be up to three months

Other key issues

- There are a number of other issues that remain to be resolved for the REFIT programme to be successful, including:
 - Identity of Buyer and Government support
 - Procurement process
 - Risk allocation in the PPA
 - Lender considerations
 - Connection to the Grid

1. Identity of the Buyer

- The buyer of power under the REFIT PPA needs to be confirmed
 - the NERSA Guidelines and the PPA both refer to Eskom’s “Single Buyer Office” as being the renewable Energy Purchasing Authority
 - however, the Regulations define the buyer as “*any organ of state designated by the Minister in terms of Section 34(1)(c) and (d) of the [Electricity Regulation] Act.*”
 - No buyer has been appointed pursuant to the Regulations as yet
- Eskom currently has multiple roles
- Government announcement of ISO – Bill now published but timing unclear

Identity of the Buyer (cont)

- Announcement by Eskom of establishment of “Fully ring-fenced” Independent Systems and Market Operator (ISMO) within Eskom
- This is not be a separate legal entity – will be a division within Eskom initially
- Interim solution - independent ISMO will take longer to establish
- Role of ISMO beyond purchasing power from IPPs – wide role contemplated by ISMO Bill
- Party to initial PPAs likely to be Eskom with ability to assign
- Government support will be needed

2. Procurement Process

- Draft Selection Criteria for Renewable Energy Projects under the REFIT Programme published by NERSA on 19 February 2010
- NERSA received some 66 written submissions and 25 presentations made as part of subsequent public consultation
- March 2009 Guidelines had suggested a “first come, first served” approach but (now repealed) 2009 Regulations and draft selection criteria make it clear that selection will involve a tender
- Revised/final rules awaited
- New Regulations provide for the “procurer” to determine form of procurement programme – will this be DoE initially and the ISMO in due course?
- Draft criteria a combination of “gate keepers” (pass/fail) and point based weighting
- Draft criteria raise a number of questions

Procurement Process (cont)

- Minimum Project Size
- Evaluation process - some criteria are forward looking e.g. jobs per MW
- What happens if criteria not met e.g. project late or jobs not created?
- Requirement to meet connection costs “*in full up front*”
- Preference for projects with “*fully underwritten*” financing
- Preference for projects that can achieve COD within 10 months
- BEE (Black Economic Empowerment) both gatekeeper and points based
- Not clear if acceptance of a standardised PPA will be a gatekeeper or mark-ups will be allowed – either approach has pros and cons
- RFI suggests final criteria will contain strong local content element
- How will published criteria tie in with PPPFA requirements and DoE’s proposed process?
- It seems clear that there will be a first mover advantage although this may be mitigated by rolling procurement and price competition

3. Risk allocation in the PPA

- Risk allocation in the PPA favours the Buyer and impacts on the bankability of the PPA
- For example:
 - there are limited protections for the Seller for risks outside its control
 - there is no financial protection for law changes
 - there are hair trigger termination rights for the Buyer
 - there is no termination compensation regime
 - the PPA does not deal adequately with the possibility of any industry restructuring which affects the Buyer such as creation of ISMO
 - does not contemplate phased completion
- NERSA and Government stakeholders seem to have taken on board the need for the final PPA to contain a balanced and bankable risk allocation consistent with international project financed PPAs to be attractive to investors and developers

4. Lender Considerations

- PPA acknowledges requirement for Direct Agreement but lacks detail. Lenders will expect Direct Agreement covering matters such as:
 - termination rights of the Buyer to be subject to extended cure periods
 - lenders' step in rights
 - lenders to be named as co-insureds on Seller's insurance policies, and insurance proceeds to be applied by the Seller subject to the requirements of the lenders
- Final suite of documents expected to include a standard form Direct Agreement dealing with key lender requirements

5. Grid Connection

- While the REFIT documents refer to “guaranteed access” to the Grid, they do not explain how this will be achieved. Nor does the PPA provide relief for the Seller for any delays in connecting the facility to the Grid (as discussed earlier)
- Guaranteed and priority grid access is a key requirement of any successful REFIT programme
- Developers and lenders will be looking for the final documentation to provide:
 - which party is responsible for which aspects of the connection to the Grid, e.g. any required Grid strengthening, local connection
 - the compensation available to the Seller for any delay in connecting the facility to the Grid. A concept of “deemed completion” would normally apply, permitting the Seller to receive income payments (on a liquidated basis) for the period from the Scheduled COD until actual connection to the Grid

The Way Forward – Realising the Potential of Renewables

- While there have been some encouraging developments by NERSA and Government since 2009, there have also been setbacks along the way. The potential remains for a successful renewables programme but there are still a number of key steps needed:
 - Clarifying/confirming tariffs (and how they fit in selection process)
 - Clarifying regulatory regime and price competition element of selection
 - clarifying and finalising the process and rules for the selection of RE generators as soon as possible
 - aligning the documentation
 - confirmation of identity of buyer and timing/process with regard to ISMO
 - confirmation of grid connection terms
 - publishing revised PPA(s) with balanced and bankable risk allocation
 - releasing associated project documentation (e.g. Connection Agreement, Distribution/Transmission Use of System, and Direct Agreement)
 - publishing a clear time table to implementation, both for round 1 and future procurement rounds

REFIT's Potential for the Economy

- Energy is a key driver of economic development
- New job creation
 - Estimates suggest that SA's renewables sector could create over 145,000 jobs in the country
 - Indirect impact could be even greater
- New Industry Creation – both domestic and exportable
- Foreign investment
 - SA's REFIT programme has attracted interest from leading overseas developers of RE technologies
- Skills development
 - Skills development and transfer, can be exported to other countries

But how will price tendering impact on these benefits being realised?

DEWEY & LeBOEUF

Any Questions?

Contact:

Scott Brodsky

Dewey & LeBoeuf

Tel: +27 11 911 4303

Email: scott.brodsky@dl.com

Dewey & LeBoeuf LLP