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

Presentation to SANEA

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Introduction

- Energy Crisis in South Africa and Region
- Tremendous Need Translates to Tremendous Opportunity
- Pace of Change Accelerating as Momentum Gathers
- Opportunities for IPPs, Renewables (including REFIT) and Transmission
- Opportunities both in South Africa and throughout the Region – huge investor interest
- South Africa's REFIT Programme Taking Shape

Outline

– What is a FIT?
– South Africa's REFIT Programme – the Story So Far
– Latest Developments
– Key Outstanding Issues
– REFIT's Potential for the Economy
– The Way Forward – Realising the Potential of REFIT
– Timing
– Questions

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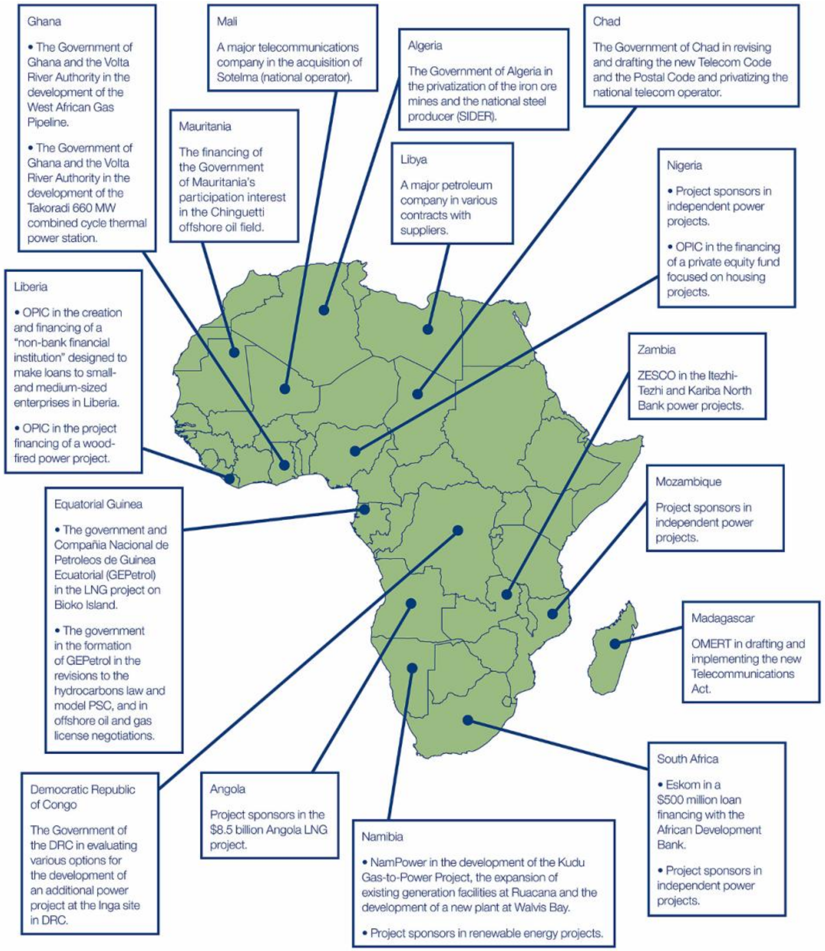

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What is a Feed-In Tariff?

- Way of encouraging growth in renewable energy generation
- FITs set a fixed price for renewable power
- Guaranteed long-term offtake
- Guaranteed and priority grid connection/access
- Often "first come – first served"
- FIT programmes around the world have proven highly successful at achieving renewable power generation as well as job creation

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South Africa's REFIT Programme – The Story So Far

- White Paper on Renewable Energy – November 2003
- NERSA consultations followed by March 2009 Regulatory Guidelines setting out:
  - basic structure of REFIT programme
  - roles of parties including NERSA and Eskom
  - proposed FITs for four technologies
    - Landfill gas
    - Small hydro (less than 10 MW)
    - Wind
    - Concentrated solar power (CSP) with Storage (6 hours)

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South Africa's REFIT Programme (cont)

- Following March Guidelines, NERSA issued a Consultation Paper in July 2009, setting out:
  - a further six technologies to be included in the REFIT programme
    - ♦ Concentrated solar power (CSP) without storage
    - ♦ Solid Biomass
    - ♦ Biogas
    - ♦ PV (large ground or roof mounted)
    - ♦ Concentrating PV
    - ♦ Concentrated solar power (central tower)
  - a form of REFIT PPA, based on MTPPP
- NERSA invited written submissions and comments on the REFIT programme, including the form of REFIT PPA, at public hearings held in September 2009

South Africa's REFIT Programme (cont)

- Electricity Regulations on New Generation Capacity promulgated on 5 August 2009, dealing with both IPPs and REFIT
- NERSA issued its “Decision on REFIT 2” on 30 October 2009
  - Decision set FITs for further technologies added through the Consultation Paper, but did not include FIT for Concentrating PV as cost considered too high
- Revised IRP1 determination published 29 January 2010

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South Africa's REFIT Programme – Latest Developments

- Establishment of Inter-Ministerial committee on energy in February 2010
  - objective to develop a 20-year integrated resource plan (IRP) for new generation capacity
  - also looking at the participation of independent power producers (IPPs)
- Announcement of planned establishment of an independent system operator, separate from Eskom Holdings
- NERSA publication of Regulatory Rules on Selection Criteria
- Work on IRP2/2010 well underway
- August 2009 Regulations expected to be revised

Some general issues with SA's REFIT programme

- The REFIT programme is a good start, but some issues remain to be resolved for it to be successful, including:
  - Identity of Buyer
  - Procurement process
  - The role of the IRP
  - Risk allocation in the PPA
  - Lender considerations
  - Connection to the Grid

1. Identity of the Buyer

- It is not clear who the buyer of power under the REFIT PPA will be, and whether there will be more than one buyer
  - 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 person or entity designated by the Minister in terms of Section 34(1)(c) and (d) of the [Electricity Regulation] Act and authorised under a licence;* …", thus re-opening the issue of the identity of the Buyer
- No buyer has been appointed pursuant to the Regulations as yet
- Eskom currently has multiple roles
- Government announcement of ISO but timing unclear

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Identity of the Buyer (cont)

- Announcement that “Fully ring-fenced” Independent Systems and Market Operator (ISMO) to be established within Eskom by end August
- Not expected that this will be a separate legal entity – will likely be a division within Eskom initially
- Interim solution - independent ISMO will take much longer to establish
- Role of ISMO beyond purchasing power from IPPs to be clarified
- Party to initial PPAs likely to be Eskom with ability to assign
- Government support will be needed

2. Procurement Process

- Regulatory Rules on Selection Criteria for Renewable Energy Projects under the REFIT Programme promulgated by NERSA and published on 19 February
- 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 Regulations and draft selection criteria make it clear that selection will involve a tender, albeit not on price
- Revised/final rules to be published by NERSA
- Suggestion of separate cogeneration feed-in tariff (COFIT)
- Criteria a combination of “gate keepers” (pass/fail) and point based weighting
- Rules raise a number of questions

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Procurement Process (cont)

- Technology preferences/caps
- Minimum Project Size
- Timing of initial and future procurement phases
- 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
- Not clear if acceptance of a standardised PPA will be a gatekeeper or mark-ups will be allowed – either approach has pros and cons
- It seems clear that there will be a first mover advantage – dilemma for sponsors

3. Role of the IRP

- Impact of the IRP (Integrated Resource Plan)
  - the Energy Regulation Act 2006 and the Regulations refer to the “integrated resource plan”, which is to be taken into account by NERSA as one of the criteria for the selection of IPPs (see Regulation 7(3)(a))
  - the IRP, promulgated for consultation in January, provides that it shall be a policy objective that by 2013 10,000GWh of energy shall come from renewable energy sources (approx 4% of the energy mix), procured through the REFIT, MTPP and Eskom’s Sere [wind] and CSP programmes
  - IRP1 very brief document and only covers period until 2013
  - IRP2/2010 preparation well underway – expected to increase targets substantially

Role of the IRP (cont)

- IRP 2/2010 – latest indications from DoE on timetable
  - Commence Modelling - July
  - Base Case with Scenarios Ready – Mid August
  - Complete 1st Draft IRP 2010 – End August
  - Draft IRP2010 published for public consultation - September
  - Public hearings on Draft IRP 2010 - September
  - Revised 2nd Draft IRP 2010 - October
  - Promulgate IRP 2010 - November

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Role of the IRP (cont)

- IRP 2/2010 – Developments
  - Extensive consultations already carried out – 81 submissions and 831 inputs provided; high proportion related to renewables
  - Respondents calling for 20-75% renewables by 2050
  - DoE Presentation to Parliamentary Committee on Energy on 3 August
  - Renewable Energy assumptions for base case include:
    - Wind – 500 MW in 2013 and 1000 MW per year thereafter
    - CSP – 500 MW per year from 2018
    - PV – 100 MW per year from 2018

4. 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 stabilisation clause 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

Risk allocation in the PPA (cont)

- 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
- Crucial that the final PPA and related documentation is the right side of the line in terms of risk allocation and bankability – market is expectant
- Testing the market through putting out an unbalanced and unbankable suite of documents – even assuming that mark-ups are allowed - could jeopardise the success of the entire programme
- Possibility of private sector consultations before documents finalised

5. 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

6. 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

REFIT’s Potential for SA’s 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
- 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
- Preference in Regulations for small distributed generators, local economic development and advancement of historically disadvantaged individuals

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The Way Forward – Realising the Potential of REFIT

- While NERSA's and Government's progress to date have been encouraging, they must maintain the momentum, including taking the following steps:
  - clarifying and finalising the rules for the selection of RE generators as soon as possible
  - aligning the REFIT documentation
  - confirmation of identity of buyer
  - confirmation of grid connection terms
  - revising the draft PPA to achieve a balanced and bankable risk allocation
  - releasing associated project documentation (e.g. Connection Agreement, Distribution/Transmission Use of System, and Direct Agreement) for review
  - developing a clear time table to implementation

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Timing

- A number of moving parts need to come together, including:
  - RFQ/RFP – decision and drafting
  - Selection Criteria – now ready?
  - Standardised PPA and related documentation (Connection Agreement, Distribution/Transmission Use of System, and Direct Agreement)
  - IRP2/2010
  - [ISMO]
  - [Update to Renewable Energy White Paper]

- Optimistically, late Q3/Q4 2010 but could slip unto 2011

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Questions?

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