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RESOLVING THE IPP PROCUREMENT IMPASSE

Portfolio Committee on Energy
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POLICY AND PLANNING CONTEXT OF IPP PROGRAMMES



Policy and Planning Context

- The **White Paper on the Energy Policy of the Republic of South Africa (1998)** commits to implement various electricity market reforms, including:
 - Encouraging **private sector participation** in the industry – Independent Power Producer Procurement Programme (IPPPP)
 - Encouragement of **competition and the restructuring of Eskom**
 - Permitting **open, non-discriminatory access** to the transmission system
- **Electricity Regulation Act, 4 of 2006 (ERA)** formalised White Paper to *inter alia* provide for:
 - **Minister of Energy to determine** that new generation capacity is needed, require private sector participation (IPPs) and that the electricity **must** be purchased by such a designated buyer (Eskom)
 - **Non-discriminatory access to the transmission and distribution power systems** to third parties (section 21(3)), thereby enabling private sector participation in electricity generation.



Policy and Planning Context

- **Implementation** received concerted impetus with **extreme security of supply constraints and consequential load shedding** in 2008/9 - **Severe Eskom financial constraints** due to its new build Medupi and Kusile projects
- **Inter-Ministerial Committee (IMC) on Energy** established in December 2009 to address electricity supply constraints
 - IMC tasked a **special Working Group (comprised of national departments of government and public entities**, i.e. DoE, NT, Department of Public Enterprises (DPE), Eskom and NERSA) to identify the blockages preventing private sector investment in the electricity generation market, remove the blockages and enable private sector investment
 - It was recognised by IMC that Eskom would be conflicted acting as both an energy provider as well as the procurer of IPPs – thus, Department of Energy designated as procurer and Eskom as buyer
- **Integrated Resource Plan (IRP)** promulgated in 2010 - subsequent new generation capacity determinations have been informed by the MW allocation and commissioning dates per technology type



Policy and Planning Context

- South African government, business, labour and civil society entered into the **Green Economy Accord** in November 2011 followed by participation in the **United Nations Climate Change Convention Conference (COP17)** in Durban amidst progressive expectations to reduce the country's carbon emissions footprint and increase the diversity of green energy mix
- **First determination** for new generation capacity under Sec34 of the Electricity Regulation Act by the Minister of Energy, in concurrence with the National Energy Regulator of South Africa (NERSA) was issued in August 2011 **initiating the Renewable Independent Power Producers Procurement Programme (REIPPPP)**



Policy and Planning Context

- The IPPPP has and continues to contribute directly to **FIVE** of the **nine-point plan** initiatives:
 - **Resolving the energy challenge** - *The energy challenge remains a key consideration as the draft IRP projects a supply shortage by 2023*
 - *IPPPP is a direct contributor to new private sector funded generation capacity brought on-line timely, within budget and at predictable prices;*
 - *REIPPPP already procured **6376 MW in less than 5 years of which 3162 MW is already online***
 - ***Coal-fired IPP** procurement programme procured 2 coal-fired IPP projects of 864 MW*
 - **More effective implementation of a higher impact Industrial Policy Action Plan:**
 - *Through local content spend of R35.5bn to date, REIPPPP has attracted new investment in local manufacturing, for example solar*
 - 8 *PV panels and wind towers*



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THE ROLE OF IPPs



What is an IPP?

- A company (consortium) owned by:
 - **Black Industrialists (increasing shareholding with projects to be signed having an average of 40% shareholding)**
 - Other South African shareholders (including institutions such as the PIC)
 - Community Trusts representing the local communities where the projects are located
 - Foreign shareholders bringing foreign direct investment (FDI) that improves the country's balance of payments as well as expertise



The role of IPPs

- The draft IRP currently in process of finalization is clear about the requirement for new generation capacity from 2023.
- IPPs can play an important part in providing the new capacity within the **current constraints experienced by Eskom and the Fiscus** as IPPs:
 - Provides **ALL the funds (private sector balance sheet) for** the construction and operation of the power plant – through debt (mostly) and equity
 - Bears **ALL the construction and site risks** of the project – any delays or cost overruns are for the account of the IPP and not recoverable
 - **Commits to a specified date to start generating power and is penalised if late**
 - **Manages at own risk the operation of the power plant** for a period of 20 years (or more) and ALL cost overruns (for example increased maintenance cost) are for the account of the IPP and not recoverable
 - **Only starts recovering its investment when the power plant starts producing power and the consumer only pays for energy generated**
 - **Charges pre-determined and predictable prices** – price adjustments CPI linked
 - Bears **ALL the risk of reduced revenues** when the power plant is not operational or produces less power
 - **Commits upfront to** achieving targets in respect of **job creation, economic development (enterprise development and preferential procurement) and socio-economic upliftment**



The role of IPPs/ Ctd.

- **Government's exposure which is only to honour Eskom's payment obligations will only be triggered** in the event that Eskom cannot meet its obligations as a consequence of **Eskom's failure to recover its costs through the regulatory cost pass-through mechanism under the Electricity Regulation Act, 2006**
- **Government is in control** of any expropriation or nationalisation event and in such case will receive an asset in lieu of the payment of compensation



Projects ready to be signed at 11 April 2017

	Large REIPPPP Bid window 3.5	Large REIPPPP Bid window 4	Small REIPPPP Bid Window 1	TOTAL
No of projects	1 Project	12 Projects	6 Projects	19 Projects
Location	Northern Cape	Northern Cape (8) Eastern Cape (2) Western Cape (1) Mpumalanga (1)	Northern Cape (3) Western Cape (2) Mpumalanga (1)	Northern Cape 12 Western Cape 3 Eastern Cape 2 Mpumalanga 1
Total MW	100 MW	926.02 MW	29 MW	1091.02 MW
Total Project cost	ZAR 8.8 billion	ZAR 21.8 billion	ZAR 1 billion	ZAR 31.6 billion
BBEEE shareholding (Ave)	19.7%	33%	28%	
Enterprise Development Contributions	ZAR24.6 million	ZAR593 million	ZAR22 million	ZAR 639.6 million
Socio-Economic Development Contributions	542 million	ZAR2.3 billion	ZAR 151 million	ZAR 2.993 billion



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PROGRESS TO RESOLVING IMPASSE



Eskom Position: Summary

- Since June 2016 Eskom has communicated, both publicly and in direct correspondence to the Minister of Energy, its **reluctance to continue** its participation in the REIPPPP - through various correspondences and through media statements Eskom claims that:
 - REIPPPP projects resulted in a **higher cost to Eskom than it could recover through tariffs paid by its customers and thus had an adverse impact on its balance sheet.**
 - The **REIPPPP would cost the South African consumer more than would otherwise be charged for electricity**, adding 4.9% to tariffs
 - The REIPPPP is not needed as there is an **oversupply of electricity** and lower demand as a result of low GDP growth
 - **Shutting down of 5 coal-fired power stations is as a consequence of the renewable IPPs**
- In January 2017 Eskom verbally indicated **willingness to only sign the agreements** pertaining to Projects whose price, in nominal 2016 terms, is **equal to or less than 77c/kWh**. It has subsequently indicated that the **price for Bid Windows 3.5 and 4 must be negotiated**
- Eskom notified the Ministers of Finance, Public Enterprises and Energy of its call on the Government Support Framework Agreement (GSFA) for **Direct Eskom Financial Support** as an effective measure to meet its payment obligations under S34 IPP PPAs as they become due and payable

Summary of Discussions to Resolve Impasse



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- DPE/DPE/Eskom and IPP Office have engaged in order to narrow the gap between the various positions
 - Insofar as overcapacity concerns, there is consensus regarding how to address the issue
 - Medium term outlook for period up to 2021
 - IRP Update for period beyond 2022
 - Insofar as financial impact on Eskom, a process has been initiated as outlined below



Risks to Government if no resolution

- Government exposure to litigation risks due to the current pending procurement.
- Government exposure in terms of increased contingent liabilities if Eskom defaults.
- Potential sovereign downgrade.
- Commitment by Government to Climate Change.
- Lack of clarity regarding the progress of the program is creating uncertainty in the Market negatively affecting investor confidence.



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NEXT STEP AND TIMELINES



Intervention to achieve Signing...

- Borbet Judgment (a successful challenge by some electricity consumers in the High Court that delayed the resolution of the RCA in 2017) has since been appealed by NERSA and Eskom, thus enabling the tabling of the RCA again.
- Team comprising National Treasury, Departments of Energy and Public Enterprises, IPP Office and Eskom has progressed as follows:
 - Eskom to proceed with RCA application
 - Eskom to approach NERSA regarding Eskom hardship
 - DPE/DoE/NT to develop the case for Eskom soft support until tariff adjustment in 2018
 - DoE to conclude the update of the Integrated Resource Plan (IRP), so as to define the pace and scale of new generation capacity from 2021 onwards
 - DoE/IPP Office to review the pace and scale of rollout under the circumstances of Eskom hardship and overcapacity up to 2021
 - Team to review the level of participation by Black Industrialists and to increase it
- In the medium term the Team to consider broader IPP policy issues including:
 - Improving the impact of IPP programme in relation to government objectives (e.g. lowering the electricity price path, reducing the adverse impact on Eskom balance sheet, electricity market structure, contribution to energy mix, Black Economic Empowerment, jobs contribution and closure of coal mines etc.)

Steps and Timelines...



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	<i>Intervention</i>	<i>By</i>	<i>When</i>
1	Proceed with tariff and RCA application	Eskom	May 2017
2	Approach NERSA regarding Eskom hardship	Eskom supported by DoE/DPE/NT	July 2017
3	Develop the case for Eskom soft support until tariff adjustment in 2018 and submit to NT, then to Eskom Board	Eskom supported by DPE/DoE/NT	July 2017
4	Conclude the update of the Integrated Resource Plan (IRP), so as to define the pace and scale of new generation capacity from 2021 onwards	DoE	Feb 2018
5	Review the pace and scale of rollout under the circumstances of Eskom hardship and overcapacity up to 2021	DoE	Aug 2017
6	Review the level of participation by Black Industrialists and develop strategy to increase it	DoE	Aug 2017



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THANK YOU