

## The Energy Curtailment Dilemma for IPPs

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A little more than a month ago, South Africa was grappling with Stage 6 load shedding as Eskom struggled to supply the country's electricity demand, in the face of breakdowns in their fleet of power stations and others taken offline for emergency maintenance.

In an incredible turn of events this situation has completely reversed, following the devastating effect on economic activity by the forced lockdown and onset of the COVID-19 pandemic. For the first time in many years, Eskom has a different challenge on its hands.

### Uncharted territory for Eskom

Ironically, instead of the usual plea to the country to reduce energy demand, Eskom has communicated their difficulty in managing up to 9GW of *excess* power due to plunging demand. Drastic measures have been implemented to ensure that the necessary balance between supply and demand is maintained in the transmission system. Eskom has been forced to run their power stations at minimum operating levels and is using this opportunity to undertake much needed maintenance on some units taken offline.

#### Force Majeure:

Unforeseeable circumstances that prevent the fulfilment of a contract.

#### Worrying impact on renewable energy

The Independent Power Producers (IPPs) have not escaped the impact of these extraordinary times and many of the wind farms have been issued with an energy curtailment notice from Eskom. Using the reason of Force Majeure, Eskom has proceeded to advise these IPPs that, during certain times, the power they produce will not be utilised nor

paid for by the utility, until the energy demand returns to normalised levels. In exchange, Eskom has offered to extend the term of their power purchase agreements with the IPPs.

On the face of it, the stance taken by Eskom is supported by the current events outside of its control, notwithstanding the President's appeal to Big Business to pay suppliers and not to opt for Force Majeure enactment in the interests of the country's economy, when he announced the two-week extension to the national lockdown on 9 April 2020. The risk to the transmission network from an unbalanced demand and supply is real, although questions still abound as to why more of Eskom's coal stations are not taken offline for maintenance and repairs. However, what could easily be overlooked is that very clear and detailed contractual commitments have been signed between Eskom and the IPPs. In short, the Force Majeure approach has been rejected by the IPPs as falling short of these contractual provisions.

### Even more worrying knock-on effect on pension funds

Whilst the IPPs have acknowledged the difficulty of the prevailing electricity oversupply, they are rightly claiming recourse in terms of the underlying contracts that underpin their operations and, ultimately, their viability. Billions of rands are invested in these wind farms, including the savings of pension funds, such as those managed by Futuregrowth. The ability of the IPPs to service their loan interest and capital repayments to investors depends completely on the revenue earned from the sale of electricity to Eskom.

Each wind farm's investment case is underpinned by a finely-tuned financial model that accounts for every cent of income and expenditure. In the same way, the over-arching financial covenants that govern our clients' investment risk in these projects are highly sensitive to any resulting leakage of income that may come from Eskom's Force Majeure notice. Any curtailment of electricity produced and non-payment of the corresponding revenue will directly impair the financial returns of these renewable energy projects.

Eskom's proposed extension to the power purchase agreements for a period equivalent to the curtailment is arguably not an adequate quid-pro-quo. It is impossible to predict the wind performance on those additional days in future, in order to ensure a corresponding replacement of income, and thus would result in a binary win or lose outcome for the IPPs.

## **A dangerous precedent?**

Perhaps the biggest risk of the proposed response by Eskom to managing the imbalance in their transmission system is that it sets a precedent of circumventing legally binding agreements. The Renewable Energy Independent Power Producer Procurement (REIPPP) Programme has achieved international acclaim as an outstanding public-private partnership model for renewable energy procurement.

At the heart of this successful programme is the robust legal framework that governs the relationship, rights, obligations and recourse by the parties to each project. As the national energy utility and the sole buyer of all electricity produced by the IPPs, Eskom is a key party to each power purchase agreement.

It is critical that investment confidence in the REIPPP Programme is not undermined by the current dispute between the wind farms and Eskom pertaining to the proposed Force Majeure energy curtailment. The more than R200 billion of fixed investment into the REIPPP sector to date has been underpinned by the trust that local and international investors have placed in its legal framework and, in turn, Eskom's commitment to its obligations.

## **In conclusion (is this what we want?)**

If the current deadlock between the IPPs and Eskom around energy curtailment is not resolved quickly and amicably, it is likely that the reputation of REIPPP will be compromised - and higher risk adjusted returns will be required for future investment in the sector. This could translate to higher bid prices for new tenders under the next bid window of the REIPPP Programme. Sadly, this could arrest the strong downward trajectory in the cost of renewables, which, until now, has resulted in the cheapest (not to mention cleanest) form of new power for Eskom. Is this the way we want to go?

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