

## PPP IN RENEWABLES, WHY NOT?

Renewable energy (the "RE") is the most dynamic and fast-growing area in the energy sector. Since 2015, investments in RE in developing countries and countries with economies in transition have exceeded those in developed economies. Global trends show that the renewable energy sector is already truly global, and its development has an important role for all countries, both developed and developing.

Kazakhstan's energy system, with a high degree of deterioration inherited from the Soviet Union, requires a huge infrastructure upgrade. It should be noted that the population is growing and the country's economy is developing rapidly, which in turn will affect the growth of energy consumption in the short term. Moreover, international commitments to reduce greenhouse gas emissions adopted by the Republic of Kazakhstan are possible only if the energy system is highly efficient, and renewable energy is widely used.

We believe, applying the PPP model in the Kazakhstan energy sector as a whole and in the RE, in particular, may be considered as an alternative for the RE actions actively implemented in Kazakhstan recently. International best practice shows that the use of PPP tools in the field of renewable energy became widespread. PPP tools have been successfully applied in both developed and developing countries. For instance, in the US PPP in RE mainly consist of agreements on the purchase of electricity by the state, in Europe, it is "green" tariffs and tenders for the selection of renewable energy projects. In Russia, PPP mechanisms include mechanisms for supporting RE in the wholesale and retail electricity and capacity markets. One of the bright examples is Uzbekistan, the government of this Central Asian country has implemented a tremendous amount of reform in the last three years including the PPP framework and renewable energy sector. In October 2019, Uzbekistan announced that Masdar Clean Energy of the United Arab Emirates had been awarded the country's first competitively-tendered 100 MW PV solar power plant to be implemented on PPP principles.

In this article, we briefly analyse the potential for the implementation of the PPP schemes in the renewable energy projects in Kazakhstan, the advantages and disadvantages of their use in the implementation of renewable energy projects, and will discuss the main legal obstacles to the spread of the PPP model in this industry.

Kazakhstan has extensive experience in implementing PPP and concession projects. The first law "On concessions" was adopted back in 1991, it regulated legal conditions for the provision of objects to the concession in the territory of Kazakhstan only for foreign investors. The new law "On concessions" (still in force) was adopted in 2006 (the "Concessions Law") to eliminate legal restrictions and problems that arose during the implementation of the concession projects in Kazakhstan. In order to eliminate the number of obstacles, preventing the proper application of the Concessions Law it has been systematically amended. On 31st October 2015, the law "On Public-private partnership" (the "PPP Law") was adopted. It is based on the international experience of the implementation of PPP projects and includes a wide range of state support measures of infrastructure investors, including foreign ones.

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It should be noted that PPP is a broader concept comparing to the concession. The concession, being a form of mutually beneficial cooperation of a business and the state is considered as a “subtype” of the PPP. The concession is a scheme of PPP, used when implementing the most complex and capital-intensive projects in the sphere of social infrastructure and sustenance, while PPP can be carried out in all areas of the economy, except for the restricted objects, the list of which is determined by the President of Kazakhstan.

As for the legal framework for the development of renewable energy in the country, in recent years, Kazakhstan has done enormous work on the creation of the legal and institutional framework for the implementation of RE projects, as well as the system of state support for renewable energy with the aim of gradual replacement of conventional generation by the green generation with a target of 50% of the RE share in the energy production by 2050.

Thus, in 2018 the government introduced amendments to the Law "On support for renewable energy" (the “RE Law”), which provide for the launch of auctions for the implementation of RE projects. According to the law, the bidding process on the electronic platform consists of acceptance and consideration of bids from local and foreign organizations that should be below the maximum auction price established by the state. It is worth noting that tariffs will be indexed on an annual basis in accordance with changes in the exchange rate and inflation.

### ***Status quo***

In our opinion, the RE auction bidding mechanism, taking into account the past RE action results, may be considered as a successful initiative. For instance, in the period of 2018-2019 1,205 MW of RE capacity was put up for auctions. 18 auctions were held for the total capacity of 1,021 MW. 42 winning companies signed a 15-year contract with a single off-taker Financial and Settlement Centre LLP (the "FSC"). The total installed capacity which is planned for the RE auctions in 2020 is 250 MW.

As for the use of the PPP mechanism in the RE sector of Kazakhstan, we may declare that there are certain PPP projects in the power sector, however, most of them are related to improving energy efficiency in municipal facilities. According to the statistics of the project database of the Kazakhstan PPP Centre, currently, there are about 1,335 registered PPP projects, 183 of which are related to the “Energy and housing sector”. Most of the “Energy and housing sector” projects are aimed at building power lines, improving energy efficiency through the reconstruction of thermal power plants, improving street lighting, and lighting state-owned enterprises. The project database of the Kazakhstan PPP centre shows that there are no PPP projects in the field of renewable energy at all.

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Apparently, one of the main reasons for that is that the RE sector in Kazakhstan mostly operates based on the RE Law, according to which the government sets tariffs based on the results of auctions, thereby ensuring the liquidity of RE facilities. In addition, under the RE Law the state supports connection to electricity and heat transmission networks, obliging energy transmission companies to freely and on non - discriminatory basis determines the nearest point of electric or heat networks and connect RE facilities to them.

## Implementation of the RE projects through PPP

The Law on Electricity directly provides that the design and construction of power plants, transmission lines, and substations, as well as their exploitation can be done based on PPP contracts. The current PPP legislation is quite flexible and can adapt to any industry, including the RE sector. Based on the analysis of the PPP legislation, we see that there is a certain potential in the use of PPP in renewables. Thus, the following rationale may apply to the implementation of the RE projects through PPP:

- Key drivers to pursue implementation of the RE projects through PPP:
- Currently, the FSC is not viewed as a commercially viable counterparty for the projects: lack of credit rating, lack of government guarantee, lack of capital, lack of track record.
- Contractual shortcomings under the current legislation: documents (for example, model PPA contract) and RE laws are not up to international standards.
- Tariff level: the current levels of auction tariffs do not seem attractive for the investors.
- PPP selection of a private partner may take place via holding a tender or via 'direct negotiations' (the so-called private initiative). The second option may be used by the developers of the particular existing RE object or if the developer possesses rights to a relevant land plot suitable for the project as well as grid connection arrangements in place. A private initiative has a more simplified procedure.
- The potential need for the development of energy projects in certain areas of the country that, if a competitive scheme is put in place for RE, would not be able to compete with other projects.
- Revenues: the proper budget payment instrument (state support mechanism under the PPP schemes) may provide investors with an acceptable revenue stream in addition to the auction tariff.
- Under the PPP scheme, the government and the private investor may set up an SPV for the implementation of a specific project.

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### PPP as a possible solution:

- Counterparty: the government of Kazakhstan may be a party to a PPP contract rather than the FSC.
- Contractual documentation: previous PPP transactions suggest that viable terms can be agreed with the government of the Republic of Kazakhstan based on international practice (whereas it is not the case with PPA).
- A fixed payment schedule for the entire term: the government of the Republic of Kazakhstan may take construction and operational risks. Specifically, the state may invest in the PPP projects by the way of co-financing (CAPEX), reimbursement of investment costs (CAPEX), reimbursement of operation costs (OPEX), remuneration for management of state property object; rent fee for use of object owned by a private party; and availability payment.
  - Possibility of receiving one or more of the following types of state support:
  - government guarantees on infrastructure bonds;
  - state guarantees for loans raised to finance PPP projects;
  - transfer of exclusive rights to intellectual property objects owned by the state;
  - provision of in-kind grants in accordance with the legislation of the Republic of Kazakhstan;
  - co-financing of PPP projects;
  - guarantees that the state will consume a certain amount of goods, works, and services produced during the implementation of a PPP project.
- According to the Budget Code of Kazakhstan, expenditures made in order to fulfill the government's PPP obligations shall not be subject to sequestration/reduction in the process of budget implementation.
- Pursuant to the PPP Law, the state bodies may participate in the PPP project via, among others: participation in the establishment and activities of PPP companies, granting of land plots, provision of PPP object with engineering infrastructure and provision of state support, including budget payments.

### ***The complexity with the implementation of the RE projects through PPP***

Based on the assessment of the PPP legislation, the state support measures under PPP schemes (including budget payments for construction of the PPP object) may be used by the government of Kazakhstan for specific projects of greater need for the government (projects in remote areas, off-grid systems, strategic projects) with the aim to stimulate particular RE projects where otherwise the investors would not be willing to invest even with the introduction of the attractive tariff.

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However, the PPP mechanism has its drawbacks that hinder the active application of the PPP model in the RE projects, for instance:

- PPP tender organizer or private developer (private initiative) shall defend/justify the social importance of the project, which is not required in case of RE auctions.
- Complicated and time-consuming PPP private party selection procedure (may take 6-12 months and more).
- For the PPP projects, there is a requirement to transfer RE object to state property if state support measures as co-financing and investment cost compensation are provided.
- The state support in the form of guarantee of state consumption of a certain amount of goods is still not fully developed, the mechanism for implementing this state support has not been worked out.

It is not clear how the PPP selection mechanism would work within the List of RE companies, the siting plan (grid connection), and whether the auction tariff will be provided to the developer if such a developer already obtains state support measures (budget payment for CAPEX and OPEX) under the PPP project.

PPP is less attractive from a project financing perspective since the PPP object (i.e. the power plant itself) cannot be pledged during the term of the contract, if the private partner received compensation for investment costs from the state.

Also, for many investors, the main drawback of the PPP mechanism is the need to participate in a PPP tender (if a private initiative method is not applied) and the risk, respectively, of not getting the project despite the time and resources spent.

Finally, under the RE Law, the RE producer may sell the electric power produced by the RE facility either to the FSC under the concluded PPA at fixed or auction price or to any consumers at contractual prices according to the concluded bilateral agreements. In the case of the PPA option, it is worth noting that the model PPA agreement stipulates specific deadlines for commencing construction works and commissioning of the RE facility. In this regard, due to the time-consuming private partner selection procedures within the PPP scheme, the deadlines stipulated in the PPA contract may be violated. This may consequently lead to the loss of the financial guarantee provided by the developer or even termination of the PPA unless the PPP contract is concluded prior to participating in the RE auction and PPA conclusion.

From this perspective, it seems that the PPP model is more appropriate in cases when the government is willing to provide to a private partner a guarantee of state consumption of

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electric power produced by the RE facility for a tariff agreed in the PPP contract without the involvement of the FSC and conclusion of a PPA.

### Conclusion

Success with the recent RE auctions has demonstrated the effectiveness of the auction tariff mechanism when the FSC purchases electricity from the RE producers without using rather complex PPP schemes. Due to bureaucratization time-consuming process of preparing and reviewing documentation within PPP tendering procedures as well as other barriers discussed above lead to the low interest of both the public side and the private business in applying PPP tools in the renewable energy sector of Kazakhstan.

However, given the high degree of deterioration of the energy system in Kazakhstan, as well as the country's intentions to ensure energy security and low-carbon development, the introduction of a PPP model in the green energy sector (especially for the off-grid projects) has a potential to become an alternative to the RE auction mechanism. Nevertheless, the viability of the PPP model in the RE sector is yet to be proven in practice.

In our opinion, the use of the PPP scheme may be in demand in energy projects stimulated by the state in remote areas or in off-grid systems where otherwise the investors would not be willing to invest even with the introduction of the attractive purchase tariff.

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