IPP PROCUREMENT PROGRAMMES

JUNE 2020

EVALUATION OF SELLER REFINANCING NOTICES

REFINANCING PROTOCOL / GUIDELINE

REFINANCING PROTOCOL (THE "PROTOCOL")

1. INTRODUCTION

1.1 The Department commenced with the Independent Power Producer ("**IPP**") programme in respect of renewable energy in 2011 ("**the REIPP Programme**"). Pursuant to the REIPP Programme and the awarding of Preferred Bidder status to successful bidders, the Department and Eskom have entered into Implementation Agreements and Power Purchase Agreements respectively with the project companies (the "**Sellers**"), that achieved financial close in respect of their projects. The IPP Office has been mandated by the Department to perform all contract management functions associated with the Implementation Agreements.

1.2 The Department has received and expects to continue to receive requests from Sellers to change their financing arrangements after financial close (hereafter collectively referred to as the "**Refinancing Notices**").

1.3 To deal with such Refinancing Notices and to provide Sellers with a transparent guideline which will apply to the IPP programmes, the Department and the IPP Office has developed this Protocol, which has been based largely upon National Treasury's work within the ambit of the Standardised PPP Provisions ("**Standardisation**"),[1] with further aspects adapted from the Guidance Notes issued by the United Kingdom's HM Treasury.[2] The Protocol will guide the consideration of and consent to such Refinancing Notices. As part of the Ministerial Initiative launched by the Minister of Mineral Resources and Energy in September 2019, the principles contained in this Protocol were confirmed by the Department in December 2019.

1 Refer to Standardisation Part Q: Refinancing

2 In particular, Guidance Note on Calculation of the Authority's Share of a Refinancing Gain

1.4 The Department may, upon written request, require the Seller to submit a Refinancing Notice.

1.5 This Protocol sets out a framework for the assessment of Refinancing Notices highlighting the key commercial and financial factors that will guide decision-making. The IPP Office in terms of its contract management mandate will assess, verify and grant consent as may be appropriate and as mandated by the Department.

1.6 The contents of this Protocol shall be incorporated into future procurement documentation for IPP Programmes so as to uniformly regulate changes to the financing arrangements of the Sellers.

1.7 For the purpose of this Protocol, "Refinancing" includes any change in the nature of or the terms governing the financing arrangements of a Project as captured in the base case Financial Model agreed at Financial Close and attached to the applicable Implementation Agreement ("the FC Model")[3] For the avoidance of doubt any early release of cash as a result of a change in the financing arrangements captured in the FC Model, is considered as a Refinancing and would be included within the ambit of this Protocol.

1.8 Refinancings which effect, *inter alia*:[4]

1.8.1 a reduction in interest margins applicable to the Debt;

1.8.2 a reduction or release of the cash balances in any reserve accounts or the cancellation or termination (partially or in full) of letters of credit;

1.8.3 an extension in the maturity of the Debt;

1.8.4 a rescheduling of the repayment of principal or the payment of interest included in the Debt;

1.8.5 an increase in the amount of Debt; or

[3] It should be noted that a Refinancing may also be undertaken without the direct involvement of the Seller, for example, through a special-purpose holding company which relies on rights granted in respect of the cash flows of the Project and other Project Assets of the Seller (including its rights under its contracts).

[4] This is not a closed list.

1.8.6 a change in the type of Debt (for example, from a corporate financing to a project financing, or from a bank finance to a bond finance or a combination thereof), may each have the effect of increasing or accelerating the dividends or other distributions deriving from the Project for the benefit of the Shareholders, or of reducing their funding commitments in respect of the Project. This upside (collectively, referred to as the "**Refinancing Gain**") is to be shared between the Department and the Seller.

1.9 Capitalised terms used in this Protocol, if not defined herein, are as defined in the various RFP documents for the applicable IPP Programme.

1.10 This Protocol may be updated from time to time as may be required by the Department.

2. KEY PRINCIPLES

2.1 The key principles underlying the prescribed approach to Refinancing are as follows:

2.1.1 Refinancing may be of benefit to both the Seller and the Department and, as such, a Refinancing may be proposed by either the Seller or the Department;

2.1.2 Refinancing shall constitute **any change to the financing structure of an IPP project as set out in the Financing Agreements entered into by the Seller at Financial Close ("the FC Date")**. The Department has the right under the terms of the Implementation Agreement to be fully informed of any proposed Refinancing. Furthermore, the Department have the right to consent to or decline any proposed Refinancing and where necessary in the exercise of this right of consent the approval of National Treasury pursuant to the PFMA if required may be sought.[5];

2.1.3 The IPP market in South Africa has matured resulting in better financing terms becoming available. In the broadest sense, both the public and the private sectors have contributed in bringing about this improvement. Therefore, both the public and private sectors should share in the benefits of improved terms;

2.1.4 Increases in the returns to the Seller's shareholders due to improved performance (over and above those indicated in the FC Model) should generally be for their benefit, however increased returns which derive from changes in the nature of or the terms governing the financing structure of the Project shall be shared between the Department and the Sellers shareholders;

2.1.5 The portion of the Refinancing Gain accruing to the Seller should be shared between the Seller's shareholders in the ratio of their shareholding. For the avoidance of doubt any Refinancing may not negatively impact upon the equity financing arrangement of the empowerment groups involved in the Seller.

2.1.6 **Refinancing Gains should be shared at least 50/50 between the Department and the Seller however higher percentage sharing may be negotiated on a case by case basis.**

2.1.7 Key factors to be considered in this context may include the extent to which the Tariff, as bid by the Seller, was subject to effective competition and/or the extent to which the project has performed, or is expected to perform, materially beyond original expectations;

2.1.8 The benefit of the portion of the Refinancing Gains accruing to the Department should flow through to the electricity consumer **through a reduction in the Tariff as set out in the Power Purchase Agreement (PPA).**

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5 See Sections 66(2) (a) and 70 of the PFMA.

2.2 The Department through the IPP Office will seek appropriate financial and legal advice when considering a Refinancing request to ensure that the process is implemented in accordance with the principles prescribed in this Protocol.

3. CONSENT TO REFINANCING NOTICES

3.1 For Refinancing

3.1.1 The Department through the IPP Office has the right to consent to or to decline any proposed Refinancing.

3.1.2 When evaluating a proposed Refinancing, consideration will be given to whether the effects of such proposal might increase the risks borne by the Department;

3.1.3 When considering a Refinancing Notice each request will be treated independently. There may be occasions where, for good reasons, the Department though the IPP Office may refuse to consent to a Refinancing despite the opportunity to share in the resultant Refinancing Gain.

3.1.4 As a general rule, **no increase in the overall government termination liabilities associated with the project** will be allowed as a consequence of any Refinancing undertaken.

3.1.5 The government termination liabilities associated with a project may therefore not increase past the level determined as at the date of the refinancing taking into account the payment profiles set out in the FC Model.

4. PROCESS, METHOD AND TIMING OF CALCULATING, SHARING AND PAYING REFINANCING GAINS

4.1 The high-level principles for calculating, sharing and paying Refinancing Gains are set out below.

4.1.1 Calculation:

(a) The Refinancing Gain is derived from changes in the Distributions forecast to take place after the Refinancing when compared to the position immediately before the Refinancing.

(b) The prescribed discount rate for the NPV calculation is the Base Case Equity IRR as set out in the FC Model. The Department may agree an alternative Discount Rate with the Seller where such discount rate will result in an improved benefit to the Department as a result of the applicable Refinancing.

(c) The Seller, shall in determining the sharing of the Refinancing Gain provide for the Department's share to be taken in the form of a Tariff reduction over the balance of the PPA term.

4.1.2 Sharing the Refinancing Gain:

(a) The Department's agreed share of the NPV of the gains to be derived from a Refinancing shall be calculated:

(i) Without any consideration of adjustment for past operations or performance, or making whole of the project;

(ii) Without consideration to the impact, if any, of any secondary transaction in respect of Equity executed by the Seller's Shareholders; and

(iii) After provision for the Department and Seller's reasonable costs of advisors in connection with the Refinancing, where such costs for each party shall be limited to the lesser of their actual costs incurred or 1% of the Refinancing Gain.

(b) In order to assess a Refinancing Notice, the Department will need the following information from the Seller:

(i) The FC Model with the projections that were originally used to calculate the Tariff, adjusted for any Department approved changes in the Project structure and financing (including any prior Refinancing consented to by the Department) which have taken place since the FC Date.

(ii) Details of the actual timing and amounts of the cash investments of the Equity and the Shareholder Loans from the Signature Date to date (and estimated to the Refinancing date);

(iii) Information on the actual cash flow and financial results of the Seller from the Signature Date to date (and estimated to the Refinancing date), all set out under the same headings as in the Base Case Financial Model;

(iv) Details of the actual timing and amounts of all Distributions from the Signature Date to date (and estimated to the Refinancing date);

(v) A pre-Refinancing Financial Model, based on the model in (i) above, updated with detailed projections for the cash flow of the Seller from the estimated Refinancing date to the end of the Project Term including projected Distributions before taking the relevant Refinancing into account,

(vi) A term sheet and other relevant information on the terms of the proposed Refinancing;

(vii) A post-Refinancing Financial Model, based on the model in (i) above, updated with the projections for the cash flow of the Seller from the estimated Refinancing date to the end of the Project Term, including projected Distributions after taking the relevant Refinancing into account but before allowance has been made for the parties' reasonable costs calculated in accordance with 4.1.2 above and the Department's share in the Refinancing Gain;

(viii) A calculation of the Refinancing Gain as set out in 4.1.1;

(ix) Information on the assumptions for the projections in the pre-Refinancing and post-Refinancing Financial models; and

(x) Completed pro-forma Excel worksheets to be supplied by the Department as part of the Refinancing Initiative.

4.1.3 Payment of the gain share:

(a) The Department through the IPP Office will invoice the Seller for its reasonable costs, calculated in accordance with 4.1.2(a), within 15 days after Financial Close of the Refinancing for payment into the applicable nominated account.

(b) The Department's share of the Refinancing Gain calculated after allowance for the parties' reasonable costs calculated in accordance with 4.1.2(1a) shall be taken as a reduction in the Tariff or other equivalent deferred payment arrangement.

(c) **The reduction in the Tariff or equivalent arrangement shall not be conditional on the future performance of the project.**

(d) The indicative process and a possible timetable for the Department's potential consent to a Refinancing is as follows:[6 7]

Timing*	**Action**
RD – XX BD	The Seller submits a Refinancing Notice to the Department with an outline proposal for a Refinancing; the Parties agree the basis on which the Department, the Seller will be compensated for its costs, including costs of advisers, if the Refinancing does not proceed.[8]
RD – 15 BD	The Seller provides information on the Refinancing and a projection of the Refinancing Gain.

[6] Adapted from the United Kingdom's HM Treasury Guidance Note on Calculation of the Authority's Share of a Refinancing Gain.

Timing*	Action
RD – 15 BD	The IPPO reviews the terms for the Refinancing and agrees the way in which the Seller's estimate of the amount of the Refinancing Gain is calculated.
RD – 15 BD	The IPPO and the Seller agree the revised Tariff schedule.
RD – 15 BD	The IPPO final consent to the Refinancing. (This may be subject to review of any further changes in documentation; changes to the Implementation Agreement and PPA).
RD	Financial Close for the Refinancing is achieved by the Seller.
RD + 15 BD	Final calculation and payment of the Department's costs.

* RD = Refinancing date; BD = business days.

(e) This timetable is indicative, as the circumstances of each transaction will be different, but it is considered a reasonable timescale for the decisions which the Department has to take in consenting to a Refinancing.[9]

(f) Although the Department through the IPP Office will endeavour to ensure the timeous processing of the amendments to licences by Nersa and for Eskom to follow due process to approve the amendments to the PPA, reasonable time must be added to the process for this purpose.

[9] These timeframes are premised on the basis of a single Refinancing Notice. In the event that more than one Refinancing Notice is received by the Department and these are required to be assessed simultaneously, the Department depending of resources available may require additional time beyond that indicated in these timeframes and, accordingly, these indicative timelines will be adjusted.

5. AUDIT RIGHTS

5.1 Sellers will be required to provide a model audit review opinion in respect of the Financial Model(s), prepared and signed by a suitably qualified professional firm. The letter must be addressed to both the Project Company and the Department.

5.2 The Department acknowledges that the Seller will receive this audit letter in the style of the individual professional firm and it will contain that firm's risk management material and disclaimers. However, the opinion letter must confirm, at a minimum, the information detailed below:

(a) That the auditor will have responsibility and a duty of care to both the Department and the Seller;

(b) That the Financial Models reviewed are consistent with the Financial Models submitted to the Department for review and used for the purposes of executing the applicable Refinancing;

(c) That the discount rate used have been confirmed and evidenced.

(d) The logical integrity, internal consistency and arithmetic accuracy of the formulae, algorithms and calculations within all cells of the Financial Model(s) have been ascertained;

(e) The Financial Models have been prepared in accordance with the relevant accounting standards and the current or envisaged taxation framework; and

(f) The Seller's reasonable costs of advisors in connection with the Refinancing are accurate.

END