BRACEWELL

INSIGHTS

Sustaining the Green Energy Revolution

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*By: **Andrej Kormuth** and **Shayan Najib***

As greenfield renewable energy developments accelerate in size and volumes, while potential investors begin to rumble about sky-high prices in the renewables secondary market, questions are being asked whether a bubble is forming. We consider (on the back of our extensive renewables credentials) how a rift is beginning to form between age old parallels of risk and reward, seemingly on the back of green energy exuberance (solar, wind, hydrogen), and how managing that rift will be key to the long-term sustainability of the green revolution within MENA.

Scaling

It is by now a familiar story – eye watering size of renewables plants, dotted around the whole of the Middle East. Gone are the days of 10 MW, 20 MW or 50 MW solar or wind IPPs. Anything less than 100 MW appears to be categorised as small, usually accompanied with the mental images of lonely couple of solar modules perched on a roof top, as opposed to the industrial scale of panels that a mere 10 MW plant requires.

To put it into perspective, the Al Kharsaah 800.15 MW solar PV IPP in Qatar that we closed (credit in particular to Marubeni Corporation, Total Solar and QP) in July last year involved over two million bifacial photovoltaic modules, strewn across 3.86 square miles. Marubeni and Aljomaih’s 300 MW Rabigh IPP in Saudi Arabia (which we closed in April this year) is half that size, but still involves a volume of space and solar modules that most cannot fathom. And this is only the beginning! Even the scaling solar deals, which historically adopted more humble volumes, are now running into hundreds of MWs of power. The latest example of these are the Asian Development Bank and IFC guided deals in Uzbekistan, numbering three projects in total and ranging between 180-220 MW each.

More commonly known for its fossil fuel laden economies, it is quickly becoming the worst kept secret that the Middle East has in the past several years turned into a regional (if not global) hub for renewables development. The scale of greenfield developments either closed or near closing in the last 12 months alone speaks for itself: 1.4 GW of solar IPPs under Saudi Arabia’s second round of renewables (with more than 1 GW planned under the third round), 800 MW in Qatar, 500 MW in Oman and roughly 5.3 GW of solar IPPs (yes, that that’s right) in Dubai and Abu Dhabi alone. This is obviously not to mention the extensive green and brown hydrogen initiatives taking place across the region, including (most recently) ADNOC’s planned USD$2.2 billion 420 MW hydrogen fired power plant.

So why is this happening? Apart from good will, the fundamentals appear to support it: regional energy consumption is trending upwards at the rate of 5 percent per annum, which is coupled with shortage of readily available natural gas supplies, thus (as the argument goes) expanding the motivation for renewables capacity, particularly solar (given the abundance of sunshine). The macroeconomic view also appears to support the ongoing trajectory of this development frenzy. The Arab Petroleum Investments Corporation (Apicorp) recently released its regional 2021-2025 investment report, which concludes that approximately USD$805 billion of energy investments will be made regionally in the next 4 years. The particular point of interest is that while oil takes approximately 28 percent of that pie, there is a visible drop between projects committed (USD$127 billion) and projects planned (USD$99 billion). The power sector (which again is increasingly renewables minded) shows a ramp-up trend, with USD$93 billion of committed projects versus USD$157 billion of planned deals.

The two roads diverging

But as encouraging as these statistics and estimates might be (if only with the view of saving our planet!), the ground level perspective reveals multitude of issues. Commercially, the market is glowing red-hot with hyper-competition, seemingly forcing developers to accept lower and lower returns against a potentially deteriorating risk profile.

It is no secret that almost all GCC states are either implementing or seriously considering a restructuring of their energy generation and distribution regimes, resulting in brand new offtaker corporate vehicles or substantially rebalanced purchasers of power whose aggregate credit profile is well below their historic predecessors. Coupled with increasing reluctance by governments to stand by the commitments of such offtakers, we are dealing with long-term concession based power projects, which may arguably be underpinned by sensible commercial rational, but are also laden with legal risks.

Moreover, procurers are revisiting their historic precedent deal profiles and asking questions around the risk allocation regimes contained in other states. While such an approach, on a holistic level, is healthy, the exercise might be less productive when specific, procurer friendly positions are cherry picked from neighbouring jurisdiction models without appreciation for other (procurer unfriendly) positions which such jurisdiction models contain. The net effect being the deterioration of the overall risk profile of a deal as against its historic precedents. It is also a self-feeding animal, as more legal risk is successfully pushed by procurers on to the developers and its financiers, so the appetite grows for ongoing risk allocation reforms, resulting in even more developer unfriendly positions in the subsequent set of deals.

So what, you may ask? After all, the question of risk vs reward should be self-policing – in other words, the developers and their financiers are not concluding these deals under duress; they can say no.

While in the long run, that may be true, there may be inherent risks in the short to medium term. Invariably, in an environment where price is king, the sole focus of developers and contractors is on capex reduction. This might very well occur at the expense of technical quality. Solar panel modules and wind turbines are aggressively being selected on cost basis, with potentially decreasing focus on long-term functionality and performance. Operation and maintenance budgets are being slashed, with construction contractors being negotiated to the bone, leaving absolutely no margin for error or risk. And consultants, including legal counsel,

are being asked to sign off on positions which would (just five years ago) be categorised as unworkable.

Ironically, with all the cost saving going on, with one record breaking tariff after another, the future may well be more costly. The common saying, you get what you pay for, may well come true. Pursuing lowest costs will have to, at some point, result in reduction in quality. When that occurs (if it hasn't already), the risk allocation regime governing the relevant deal(s) might well become the graveyard of overenthusiastic stakeholders who had departed from risk allocation fundamentals. In short, the bubble bursts, with potentially devastating effects on the market as a whole.

What to do

It is precisely when everyone is heading in the same direction that vigilance should be of paramount importance. We (as lawyers) cannot influence the technology or procurement quality. What we can influence, however, is the terms under which the deals are struck and to what extent risks are shared or absorbed. This might sound self-serving, but rigorous legal review and appreciation for regional IPP models is more important than ever, particularly as everyone begins to talk about "cookie cutter" and "rinse and repeat" deals. This is precisely when risks are unfairly absorbed and then incrementally compounded in subsequent deals.

However, there are several key points that we frequently advise our clients to follow, because appreciating these fundamentals will usually be the difference between informed commercial decisions and blind faith:

- The long-term credibility of the offtaker is important. Consider credit default mitigants, but do cut through the noise and understand your counterparty.

- IPP risk allocation is routed in insurance. It's a fair distribution of risk, which has worked for decades. Departing from this principal is both unnecessary and unreasonable.

- Procurers are usually far more prepared to negotiate than they may appear. Although there is a fine line between being uncommercial and legally astute, rebranding sloppy legal work and negotiations for "commercial" is dangerous.

- Don't just consider redlines of project documents against precedent deals. Instead, understand the underlying risks and consider your ability to absorb or mitigate those risks. What a lot of developers take for granted is that the risk allocation regime in precedent transactions isn't always neatly contained in a project document, such as the PPA. Frequently, specific risk shortcomings are cured by the parties "offline" through (for example) side letters or "interpretation provisions" in direct agreements which ultimately amend the underlying documents. These type of changes do not reflect in redlines.

- Use good lawyers! Again, may sound self-serving, but legal counsels are the architects of your deal. What is the use of spending a billion dollars on a house only for it to be unliveable due to bad design. Similarly in the context of IPPs, it definitely pays to buy quality legal advice.

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