

THE RENEWABLE
ENERGY LAW
REVIEW

THIRD EDITION

Editor
Karen B Wong

THE LAWREVIEWS

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Editor
Karen B Wong

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PUBLISHER

Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER

Nick Barette

BUSINESS DEVELOPMENT MANAGER

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Nick Brailey

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PREFACE

When the first edition of *The Renewable Energy Law Review* launched in 2018, renewable energy made up approximately 26.2 per cent of electric generation globally and has increased to nearly 28 per cent in the first quarter of 2020. Similarly to the renewable energy sector, which has grown steadily, this compendium has also grown and now covers 19 jurisdictions in this third edition.

The renewable energy industry at the time I worked on my first transaction in 1987 was nascent and relatively tiny when compared to the conventional power industry. Fast forward 33 years and, in 2020, it is projected that renewable energy will comprise 80 per cent of the new energy capacity in the United States. According to statistics published by Smart Energy International, renewable energy projects accounted for 176GW of energy capacity globally and over 70 per cent of new capacity globally in 2019, with wind and solar projects accounting for 90 per cent of that new capacity.

Since the ‘early days’ of renewable energy projects, it has been incredibly satisfying to see the exponential worldwide growth that has taken place over the past several decades. As a US-based partner at Milbank practising in the energy industry, I see different political environments, tax and other incentives in place in our 50 states and, having worked on multiple international projects on four different continents, I know that the regimes across the world are equally unique. This compendium has been formulated to provide you with a good overview of the legal framework and current status and challenges in structuring, financing and investing in renewable energy projects in the selected jurisdictions.

Whether you are already active in this sector or merely interested in learning more about the policies, legal structures and state of play in the renewable energy industry globally or in a particular country, I hope that this guide will aid you in your efforts as a participant in an exciting and continually expanding industry.

Karen B Wong

Milbank LLP

Los Angeles

July 2020

SOUTH AFRICA

*Lido Fontana and Yolanda Dladla*¹

I INTRODUCTION

The fundamental driver for renewable energy projects in South Africa remains the Renewable Energy Independent Power Production Procurement Programme (REIPPPP) of the Department of Energy (DoE). Prior to the formal launch of REIPPPP in August 2011, the local renewable energy market was fairly inconsequential. A lot has changed since then, with REIPPPP being heralded globally as a shining example of how to successfully implement renewable energy auction programmes. The success achieved by REIPPPP has, however, not been without its challenges. Eskom Holdings SOC Limited (Eskom), the state-owned national utility and sole offtaker of electricity from projects under REIPPPP, historically refused to sign any further power purchase agreements (PPAs) with independent power producers. However, Eskom's monopolistic stronghold over the energy sector loosened during 2018, when Eskom signed 27 independent renewable energy agreements with a combined investment value of 56 billion rand and capacity of 2,300MW from bid windows 3.5 and 4 of REIPPPP.

Eskom's historical monopoly on generation in South Africa has been gradually challenged by independent power producers that are able to deliver generating assets largely on time and on budget – key features that have been somewhat lacking in Eskom's skill set for some time, leading to above-inflation increased costs of electricity to the end users (while the tariff prices under REIPPPP continue to drop dramatically in each procurement round). Eskom is in a financial 'death spiral', owing over 400 billion rand to its creditors. In addition, by the end of 2018, South Africans were hard hit by rolling blackouts that were implemented to protect the grid from total collapse or blackout. The lack of energy capacity is due to Eskom's poor management; lack of funding or misappropriation of funds; and maintenance and labour issues. Further, the expensive and overdue operation of Medupi and Kusile coal-fired plants have resulted in the grid operating on the edge and the government of South Africa being forced to consider the unbundling of Eskom. This will result in Eskom being unbundled in three divisions, namely generation, transmission and distribution, which will positively kill Eskom's monopoly, but millions of taxpayers will face the cost of implementing this. Eskom's credit rating has also hit rock bottom, with a Standard & Poor's credit rating below sub-investment grade.

The unbundling of Eskom may make it easier for renewable energy plants to supply electricity to the national grid and the Integrated Resource Plan (IRP), which was approved in October 2019, provides that the energy mix by 2030 will consist of coal (46 per cent),

¹ Lido Fontana is of counsel and Yolanda Dladla is an associate at Covington & Burling (Pty) Ltd.

1,860MW of nuclear (2 per cent), 4,696MW of hydro (6 per cent), 2,912MW of pumped storage (4 per cent), 7,958MW of solar photovoltaic (PV) (10 per cent), 11,442MW of wind (15 per cent), 11,930MW of gas (16 per cent), and 600MW of concentrated solar power (CSP) (1 per cent). The rooftop solar market is growing at a fast rate. The Mall of Africa's solar PV system is the largest rooftop solar PV system of its kind in the southern hemisphere and 10th-largest in the world, covering an area of approximately 45,000m². The solution is estimated to produce 78,000MW annually, at a construction cost of over 50 million rand. Although the regulatory regime in South Africa does not currently allow for excess energy to be sold back into the grid, as is the case in certain parts of the United States, the sponsors (Solareff, Attacq and Atterbry) together with the National Energy Regulator of South Africa and Eskom successfully worked through a lengthy legal process to ensure lawful compliance and successful synchronisation of the system with the national grid through Eskom's grid access framework. The Mall of Africa has no doubt been a game changer for rooftop PV in South Africa, and a change in the regulatory regime allowing excess energy to be sold back into the grid would be most likely to stimulate the rooftop solar market.

There are currently no significant tax incentives or other government-led programmes that mirror those in the United States or the European Union that have fostered the growth of renewables to such an extent in those markets. Large-scale retailers (like the Mall of Africa) are now installing large rooftop solar facilities to reduce their reliance on Eskom as a supplier and what is perceived as ever increasing above-inflation tariff costs. Furthermore, reflecting international market trends, a number of international corporate entities are looking at renewable off-grid solutions. We expect this off-grid market to continue to grow, which presents a challenge for Eskom as its customer base continues to shrink.

II THE YEAR IN REVIEW

The year 2019–2020 brought with it positive change in the way of a transformation in the South African energy sector in relation to renewable energy. The Department of Energy issued the Licensing Exemption and Registration regulations (the ERA Licensing Regulations),² indicating the activities that are exempt from the requirement to obtain a generation licence and the activities requiring registration with the Department of Energy. Pursuant to these Regulations, any generation facility that does not have a point of connection need not obtain a generation licence, regardless of the generation capacity (in megawatts) and any facility that has a generation capacity of no more than 100 kilowatts with an existing point of connection should keep a register for the facility but need not obtain a generation licence. Further, the ERA Licensing Regulations indicate that a generation licence will not be required where the operation of a facility produces electricity from waste or from the residual product of an underlying industrial process, particularly in circumstances where the facility is operated solely to supply electricity for consumption by the owner of the generation facility; however, the activity must be registered. This encourages a diverse renewable energy market, making it easier for entities and individuals to participate in waste-to-power renewables initiatives. In one example of the growing move towards alternative energy and waste-to-power initiatives,

2 Electricity Regulation Act, 2006: Licensing Exemption and Registration Notice GN 402, 26 March 2020.

in March 2019, Growthpoint Properties, one of South Africa's largest real estate entities, undertook a project at its N1 City Mall property in Cape Town to install an on-site, anaerobic digester, which uses organic waste to produce green electricity.³

III THE POLICY AND REGULATORY FRAMEWORK

i The policy background

There are very limited government-led regulatory and tax incentives for renewables. As already noted, the current regulatory regime in South Africa does not allow for excess electricity from renewable sources such as residential or rooftop solar to be sold back to the grid, and a reform to allow for this would stimulate and promote faster growth in the rooftop solar market. The situation is compounded by the absence of significant tax incentives or other government-led programmes to foster development of the renewables market. Nor are there any tariff top-up arrangements like those seen in renewable energy programmes elsewhere in Africa, such as the successfully implemented GET FiT programme in Uganda. Although feed-in tariffs were initially proposed in South Africa, these were superseded by the auction process now known as REIPPPP, which has proved hugely successful, with each further round being heavily oversubscribed.

As from 1 January 2016, Section 12B of the Income Tax Act (South Africa) No. 58 of 1962 (the Income Tax Act) changed the three-year accelerated depreciation allowance on renewable energy (50 per cent to 30 per cent to 20 per cent) to an even quicker depreciation allowance of one year (100 per cent). This accelerated depreciation allowance came about from a proposal in the 2015 draft Taxation Laws Amendment Bill that the definition of solar energy be amended to distinguish between solar PV energy of more than 1MW, solar PV energy of less than 1MW and concentrated solar energy. The amended Section 12B provision now provides for an accelerated capital allowance of 100 per cent in the first year, in respect of solar PV energy of less than 1MW.

The reason for the change is to accelerate and incentivise the development of smaller solar PV energy projects, as these have a low impact on water and the environment. This is also intended to help address the energy shortages facing South Africa in a more environmentally friendly way.

Section 12B of the amended Income Tax Act provides for a capital allowance for movable assets used in the production of renewable energy. More specifically, it allows for a deduction equal to 100 per cent in respect of any plant or machinery brought into use in a year of assessment for the first time and used in a process of manufacture or any other process of a similar nature. Notably, the allowance is only available if the asset is brought into use for the first time by the taxpayer. In other words, the allowance is not limited to new or unused assets. The wording merely prevents the taxpayer from claiming the Section 12B allowance twice on the same asset.

With this incentive, companies can deduct the value of their new solar power system as a depreciation expense from its profits.

At the time of writing, the Carbon Tax Act 15 of 2019 (the Carbon Tax Act) had been signed into law. The Carbon Tax Act provides for a basic tax-free threshold of around

³ <https://www.esi-africa.com/industry-sectors/renewable-energy/3-in-1-waste-to-power-technology-in-cape-town/>.

60 per cent of emissions and additional allowances for specific sectors that may result in tax exemptions for up to 95 per cent of emissions during the first phase until 2022. The full carbon tax rate is proposed to be 120 rand per tCO_{2e}, after exemptions. The effective tax rate is expected to be between 6 and 48 rand per tCO_{2e}.

The updated IRP has provided for a small allocation of 1 per cent to the CSP technology under REIPPPP. The CSP technology is seen to provide much higher costs compared with solar PV and wind. The challenge of intermittency is likely to be solved by the ever increasing introduction of battery solutions; it is unclear, however, on what scale this can be financed in the local marketplace.

ii The regulatory framework

In South Africa, the regulation of electricity from renewable sources falls under the jurisdiction of the National Energy Regulator (NERSA), one of three energy regulators established under the National Energy Regulator Act 2004 (NRA), which regulates electricity, piped gas and petroleum pipeline industries. Eskom's tariffs are regulated by NERSA under the Electricity Regulation Act 2006 (the Electricity Regulation Act). These tariffs are based on Eskom's costs plus a reasonable rate of return.

The NRA, together with other key legislation regulating the relevant industries (in the case of electricity, the Electricity Regulation Act) establishes the framework for renewable energy regulation in South Africa. That legislation, together with associated regulations, notices, rules and guidelines, grants expansive regulatory power to the regulators, including the powers to issue, amend and revoke licences, as well as to approve tariffs.

Under the Electricity Regulation Act, a licence is required for each operation (i.e., for electricity generation, transmission and distribution facilities, and in respect of the import, export and trading of electricity – collectively, the Licensed Activities), but it provides exemptions for licences in respect of (1) any generation plant constructed and operated for demonstration purposes, (2) any generation plant constructed and operated for own use, (3) any non-grid-connected electricity supply other than for commercial use, and (4) any other activity relating to the Licensed Activities for which NERSA has determined that a licence is no longer required. In relation to the latter exemption, NERSA may require that persons undertaking the activity concerned nevertheless register it with NERSA.

A person obliged to hold a licence in terms of the Electricity Regulation Act must apply to NERSA for the licence in the form, and applying the procedure, prescribed. The application must be accompanied by the prescribed licence fee. The information required for such an application includes, among other things:

- a* a description of the applicant, including any vertical and horizontal relationships with other persons engaged in the operation of the relevant Licensed Activity;
- b* the administrative, financial and technical abilities of the applicant;
- c* a description of the proposed generation, transmission or distribution facility to be constructed or operated;
- d* a detailed specification of the services that will be rendered under the licence;
- e* a general description of the type of customer to be served;
- f* the proposed tariff and price policies; and
- g* evidence of compliance with the IRP.⁴

4 Section 10(2)(a)–(h) of the Electricity Regulation Act 2006.

The process entails publication of notices of the application in appropriate newspapers or other media and the applicant responding to objections to the application being granted, and it culminates in NERSA making a decision on the application within the prescribed period.

Transfer of control and the assignment of a licence issued in respect of Licensed Activities, including generation licences issued to IPPs, are restricted by conditions imposed on the licensee by NERSA.⁵ Accordingly, each licence must be reviewed on a case-by-case basis to determine what specific approvals are required for its transfer. However, the Electricity Regulation Act generally provides that a licensee may not cede or transfer its powers or duties under a licence to any other person without the prior consent of NERSA. The transfer of control and the assignment of licences issued to IPPs are further regulated by the implementation agreement between the South African DoE and the IPP; that agreement provides for, inter alia, government support for the development and financing of relevant IPP projects.

The initial IRP sets out the South African government's strategy for the establishment of new generation and transmission capacity for the country for the period 2010 to 2030. It calls for the doubling of the country's electricity capacity from its 2010 level of 238,272GWh, using a diverse mixture of energy sources, mainly coal, gas, nuclear and renewables, and including large-scale hydro to be imported from other countries in the southern African region. The initial IRP further details how this demand should be met in terms of generating capacity, type, timing and cost. The initial IRP also serves as an input to other government planning functions, inter alia, economic development, funding, and environmental and social policy formulation; it is also a means to determine the requirement for further investment in electricity generation capacity for South Africa.

At the time that the IRP was initially promulgated, the South African government advised that the IRP should be viewed as a 'living plan' that would be revised by the DoE every two years to ensure its relevance with regard to (among other things) technological and environmental developments in the global arena. An update to the IRP was provided for public comment in August 2018 and subsequently approved in October 2019. It became necessary to revise the initial IRP following capacity additions through ministerial determinations⁶ under Section 34 of the ERA, and to bring up to date key assumptions that have changed significantly since the promulgation of the initial IRP. Although the Minister of Energy released a draft of an updated Integrated Energy Plan (IEP), a subsequent draft has not been provided for public comment. The IEP serves as the government's master plan for the entire energy system, with its focus on the broader objective of reducing the country's energy footprint overall. The IEP regulates energy industries and promotes electric power investment, greater employer benefits and a more favourable environmental impact. The IRP on the other hand, being subordinate to the IEP, focuses specifically on electricity.

5 Section 15(1)(k) of the Electricity Regulation Act 2006.

6 A complete list of ministerial determinations can be found under appendix B of the updated Integrated Resource Plan.

IV RENEWABLE ENERGY PROJECT DEVELOPMENT

i Project finance transaction structures

A large percentage of the project financing activity for renewable energy projects has occurred within the framework of REIPPPP and the Small Projects Independent Power Producers Procurement Programme. While the project finance structure that has been adopted to date follows international norms, there are a number of unique features imposed on sponsors under REIPPPP, including localisation requirements that cover the development of specific categories of people, enterprises and communities or economic sectors. The following broad categories are covered:

- a* job creation;
- b* local content;
- c* ownership;
- d* management control;
- e* preferential procurement; and
- f* enterprise development and socio-economic development.

In terms of documentation, these follow international norms, with financing documentation largely following Loan Market Association precedents. Security packages typically include the following:

- a* borrower guarantee and share pledge;
- b* borrower cessions of its rights, title and interests in respect of aspects such as the project documentation, insurance proceeds, claims, licences, permits and authorisations under the transaction;
- c* general notarial bond, which is a registered security over all the movable assets of the borrower;
- d* special notarial bond, which is a registered security over specified movable assets of the borrower; and
- e* mortgage bond, which is a registered security over the borrower's land rights.

Construction, operation and maintenance agreements also largely follow international norms with engineering, procurement and construction contracts and operation and maintenance contracts closely following what one would expect to see in established markets. Internationally accepted standard construction contracts such as a FIDIC Silver Book are common (amended though to tailor for market norms and certain testing and performance complexities relative to each renewable energy technology).

To date, the vast majority of debt has been provided by the large five domestic commercial lenders (Rand Merchant Bank, ABSA, Nedbank, Standard Bank and Investec) with some participation from development finance institutions and pension funds (DBSA, PIC, IDC, etc.). International institutions such as the International Finance Corporation and the Organization of the Petroleum Exporting Countries have also been involved with financing a number of large renewable projects.

Aside from a large number of Enel projects (the Italian national utility) in Round 3 of REIPPPP, almost all projects have been financed on a limited or non-recourse basis.

While debt tenors vary, they are typically around 15 to 17 years (from commercial operation date) and spreads on the Johannesburg Interbank Agreed Rate are between 310 and 400 points (risk premium 250, liquidity 120 and statutory costs 30 points).

ii Distributed and residential renewable energy

Eskom, in its position as the national utility, is also the primary licensed distributor of electricity in South Africa. As was mentioned above, the current regime does not allow excess electricity to be sold back to the grid from renewable sources as it would be in jurisdictions such as the United States or the European Union, and a change in the regulatory regime would stimulate the rooftop solar market and allow it to grow far more quickly. There is also no regulated framework for use-of-system charges for embedded generators (connected to the distribution network). NERSA is, however, in the process of developing a framework for generators.

Generators that wish to wheel energy to third parties face a number of challenges related to the use-of-system charges.

iii Non-project finance development

The appetite in the market for on-balance sheet, corporate, full equity finance is extremely small. Almost all developers and sponsors of renewable projects in South Africa adopt a project finance structure.

V RENEWABLE ENERGY MANUFACTURING

The implementation of REIPPPP resulted in a significant portion of the technical equipment being imported from Europe and China. However, the increased local demand has stimulated the desirability and growth of component manufacturing for the renewable energy sector in South Africa. More recently, there has been an increase in the number of wind turbine and solar panel manufacturing plants built in South Africa, and several of these manufacturers have taken full advantage of the benefits offered to entities operating within the specifically demarcated South African Special Economic Zones (SEZs). These specifically demarcated SEZs have been set up to encourage trade and investment that create employment opportunities in South Africa and ultimately benefit the South African economy, and there are SEZs that have positioned themselves for investment in renewable energy power generation and manufacturing plants, such as the East London Industrial Development Zone.

There is a small number of solar and wind turbine equipment manufacturers currently taking advantage of the favourable SEZ laws. The Coega Industrial Development Zone, which was formed in 1999 and is located 20 kilometres north of Port Elizabeth in the Eastern Cape province of South Africa, has attracted three manufacturers of solar and wind turbine equipment, namely DCD Wind Towers, Electrawinds and Powerway. There are concerns that when these components are exported from these SEZs into South Africa, the customs and VAT levied on the components will be based on the value of the components, including South African raw materials and labour costs. This could result in a higher cost for South African customers as compared with components manufactured wholly offshore and imported directly into South Africa.

The Coega Industrial Development Zone is currently positioning itself to become the solar and wind turbine equipment hub for the Eastern Cape, as there are several renewable energy projects being proposed there. The East London Industrial Development Zone is also positioning itself to manufacture and supply electricity from renewable energy sources in the Eastern Cape Industrial Development Zones. This Industrial Development Zone has advertised that it has suitable land for electricity generation from both wind and solar

facilities, with established relations with the top 100 users and the local authority for connection of the power plant to the grid and supply of electricity to the nearby Buffalo City metropolitan municipality.

VI CONCLUSIONS AND OUTLOOK

The future looks very positive for renewable energy and the much-anticipated revised IRP will help clarify which energy sectors the new South African government will be supporting in the years to come.

ABOUT THE AUTHORS

LIDO FONTANA

Covington & Burling (Pty) Ltd

Lido Fontana is of counsel in Covington's Johannesburg office. He has significant experience in international oil and gas, mining, power, including renewable energy, and large infrastructure development transactions, including public-private partnerships and the United Kingdom's private finance initiative.

YOLANDA DLADLA

Covington & Burling (Pty) Ltd

Yolanda Dladla is a project development and project finance lawyer in Covington's Johannesburg office. She has experience of working on traditional and renewable energy projects, infrastructure development transactions and various renewable energy and liquefied natural gas projects across Africa.

COVINGTON & BURLING (PTY) LTD

Rosebank Link
173 Oxford Road, 7th Floor
Johannesburg 2196
South Africa
Tel: +27 11 944 6900
lfontana@cov.com
ydladla@cov.com
www.cov.com

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