

SYVASH – FIRST WIND PF IN UKRAINE

THE SYVASH PROJECT REPRESENTS A €380m INVESTMENT AND, ONCE COMMISSIONED, WILL BE ONE OF THE LARGEST RENEWABLE ENERGY PROJECTS IN UKRAINE. BY **ALEX BLOMFIELD**, PARTNER, AND **FRANCIS IYAYI**, ASSOCIATE, **K&L GATES LLP**, AND **OLEKSIY FELIV**, PARTNER, **INTEGRITES**.

Syvash, an area of shallow lagoons straddling the Sea of Azov in Ukrainian waters on the Black Sea, known as the Rotten Sea or Putrid Sea, is the location for a wind farm project of up to 250MW situated on approximately 1,300 hectares of land in the Chaplynka district of the Kherson region in southern Ukraine.

A subsidiary of Oslo-based utility-scale wind power developer NBT AS, and Total Eren SA, a leading renewable energy independent power producer (IPP) based in Paris (together the sponsors), and Al Gihaz Holding, a Saudi Arabian conglomerate, reached financial close on Segment 2 of the up to 250MW Syvash Wind Power Project in mid-April, following financial close on Segment 1 at the end of January.

Once the entire 250MW wind farm is completed, it will send 850GWh of clean electricity a year into the grid and can supply the electricity needs of approximately 100,000 households.

The Syvash project represents a €380m investment and, once commissioned, will be one of the largest renewable energy projects in Ukraine, proof that it is not at all true to say that “something is rotten” in the state of Ukraine when it comes to renewable energy.

Although Ukraine’s feed-in tariff for renewable energy was introduced as far back as 2009, for geopolitical and other reasons the market only started to meaningfully develop in 2016.

Today, it is fair to characterise the market as booming, with the caveat that foreign involvement is still limited due to issues in obtaining financing. Reaching financial close on Segments 1 and 2 of the Syvash project with eight international lenders and three foreign equity sponsors can only act as a catalyst for further development of the market.

Project development

There have been major reforms in Ukraine over the last four years in the area of power project development, namely in relation to securing land, grid connection, obtaining construction permits and completing environmental impact assessments in accordance with Ukrainian regulations.

The regulatory framework for electricity has also been re-shaped and a new law on liberalisation of the electricity market was introduced in 2017. It was followed by new grid

connection codes passed in early 2018, providing for transparent and fair access to the grid.

Under Ukrainian law, wind farms typically fall under a category that requires a construction permit. However, permitting procedures in Ukraine are easier than in some jurisdictions, with the construction contractor required to provide a notification of the commencement of construction works once the project has finalised its design documentation and secured relevant environmental permits.

From an environmental perspective, the environmental impact assessment (EIA OVD) required locally in Ukraine has been revised by the Ukrainian government to adopt the European assessment model.

The government’s aim was to raise standards and reduce red tape in relation to the execution of such studies. In the context of the Syvash project, NBT completed an environmental and social impact assessment (ESIA) conforming to EBRD Performance Standards and Equator Principles.

On completion of the ESIA, the EIA OVD was prepared with the content from the ESIA to ensure compliance with international standards. All requirements related to ornithology, ecology, shadow flicker, noise, cumulative impacts, layout and approach to local communities were upheld in the EIA OVD.

Going forward, to minimise the environmental impact of the Syvash project, the project company has engaged a full-time ornithologist on site for the first three years of operation, has moved some of the turbines further away from settlements to reduce the effects of noise, and has an agreed social responsibility programme to help develop the local communities surrounding the site.

The customs and tax issues involved in the Syvash project were complex. In a new approach for wind farms in Ukraine, the project agreements for the Syvash project provided for delivery duty paid (DDP) terms of delivery under Incoterms 2010, which, with specific wording and careful drafting, made the relevant contractor in each case responsible for arranging carriage and delivery of the goods at the named place, cleared for import and with all applicable taxes and customs duties paid and wrapped up in an all-inclusive EPC contract price for the goods.

TABLE 1 - SEGMENT 1 FUNDING

Lender	Segment 1 commitment amount
European Bank of Reconstruction and Development	€150m including B loans from the Green for Growth Fund (GGF) and the Netherlands Development Finance Company (FMO) in the amount of €75m
Nordic Environment Finance Corporation	€5m

Financing Syvash

The Syvash project was financed by a consortium of development finance institutions, debt, and the sponsors' equity.

Segment 1 of the project financing involved the provision by the relevant banks of an A/B loan of up to €155m for the construction of the initial 133MW of the wind park. The €155m of senior debt for Segment 1, containing 34 turbines, was signed on January 21 2019 with the following lenders and commitments of senior debt in Table 1.

Over €107m of further senior debt for Segment 2, for 29 further WTGs, was signed on April 8 2019 with the following lenders and commitments of senior debt in Table 2.

The sponsors have agreed with the lenders to have the right to enter into commitments for additional facilities following commercial operations date and to adjust the project's leverage if certain tests are met at such time.

Base equity contributions from the sponsors – NBT and Total Eren – as well as Al Gihaz Holding, exceeded €110m for Segment 1 and Segment 2.

There was such confidence in the Syvash project that the debt financing could be agreed despite the imposition of martial law during a key period for finalisation of the finance documents for Segment 1. The further volatility caused by the occurrence of presidential elections in the midst of finalisation of finance documents for Segment 2 and preparations for second financial close has also proved manageable for the parties involved in the project, see Table 3.

Currency control

A new regulatory framework for currency control in Ukraine came into effect on February 7 2019. Previously, almost every step of setting up an accounts structure, involving foreign bank accounts, had required a separate licence from the National Bank of Ukraine (the NBU), the central bank in Ukraine. However, the new regulations abolished such licensing regime while leaving a number of other requirements in place – even though these too are expected to be relaxed over time.

From a project financing perspective, the key currency control regulations to note are:

- A limit of €2m per year per resident applies to foreign currency operations by legal entities and entrepreneurs (although legal entities and entrepreneurs can carry out some transactions without limitation, such as repayment of foreign loans);
- The NBU has allowed repatriation of dividends up to 2018 inclusive and in any amount up to €7m per month; and
- The mandatory sale of foreign currency proceeds into the local currency, Ukrainian

hryvnia, has been reduced from 50% to 30%, starting from March 1 2019.

It is typical in international project finance transactions to use an accounts structure that includes offshore and onshore accounts, with strict rules for transfers into, and withdrawals from, each such account, including allowing for the accumulation of certain portions of receivables of a borrower to be applied towards servicing future principal and interest repayments under a loan.

The sponsors and their advisers, with support from the lenders and relevant agent and account bank parties, worked closely with the NBU to agree an accounts structure that meets regulatory requirements and allows for upstreaming of foreign currency to offshore secured accounts.

Power purchase agreement

The power purchase agreement (PPA) for the Syvash project is based on a template used by the offtaker in Ukraine, Energorynok, with all generators of renewable energy.

Such template has been amended several times over past years, each time intending to make the PPA template more attractive from a bankability perspective. It is important for the lenders that the revenue of the PPA is a fixed euro amount per kWh generated to adequately cover the cost of operating the facility, repay the debt and to provide a reasonable return on equity.

It is important to note that the PPA is not a standard PPA, but works within a feed-in tariff (FiT) scheme backed by legislation.

The FiT level under such scheme is linked to

TABLE 2 - SEGMENT 2 FUNDING

Lender	Segment 2 commitment amount
Black Sea Trade & Development Bank	€30m
Finnfund	€15m
IFU	€15m
Nordic Environment Finance Corporation (NEFCO)	€5m
Proparco	€42,638,036.80

TABLE 3 - KEY PROJECT ADVISERS

K&L Gates UK	Borrower's international legal adviser, English Law
Clifford Chance	Lenders' international legal adviser, English Law
Integrites	Borrower's Ukrainian legal adviser
Redcliffe Partners	Lenders' Ukrainian legal adviser
Wood Group UK Limited	Borrower's technical adviser and environmental & social adviser
Mott MacDonald	Lenders' technical adviser and environmental & social adviser
JP Morgan Securities	Financial adviser/arranger
Ernst & Young	Lenders' model auditor
JLT	Lenders' insurance adviser
Marsh	Borrower's insurance adviser
Advokatfirman Törnigren Magnell	Borrower's Swedish legal adviser
Wikborg Rein Advokatfirma	Sponsors' Norwegian legal adviser
Kanter Advokatbyrå	Swedish legal adviser

the commissioning date and is set for each commissioned facility by the National Energy and Utilities Regulator Commission of Ukraine.

The support scheme includes three main guarantees, namely the level of the FiT itself, 10.2 eurocents for each kWh for facilities commissioned in 2019, the guarantee of the state to purchase all the electricity dispatched and immunity from any retroactive changes in the law.

To take an example of a bankability point that we expect to be addressed in the upcoming template PPA, the current form of PPA requires disputes to be resolved by either arbitration in Paris under ICC Rules or Ukrainian courts, in addition to requiring the “Dispute Resolution and Negotiation Center of the Energy Community Secretariat” to assist in the negotiation of disputes.

However, typically, international financiers would require arbitration, applying internationally accepted rules, in a neutral but internationally recognised venue as the preferred method of dispute resolution.

The current PPA’s optionality for dispute resolution has been an issue on several financings in Ukraine and, therefore, an important consideration for the lenders.

Draft legislation currently in Parliament, discussed below, in relation to the new template PPA due in 2019 will remove the current bifurcated approach to dispute resolution and allow the parties to elect clearly for either international arbitration or Ukrainian courts, depending on the level of foreign ownership in the seller.

Advantageous EPC

An important element of the financing of Syvash was the standard lender expectation for the parties to enter into a suite of acceptable construction and service contracts.

As such, the parties agreed an engineering, procurement and construction contract (EPC contract) with Power Construction Corporation of China Ltd (Powerchina) and Powerchina Fujian Engineering Co Ltd, and a subcontract with Nordex Group for the supply of 63 turbines from the N131/3900 series in multiples of 3.9MW, thereby combining a Chinese EPC contractor with a leading European turbine supplier.

In addition, Syvash entered into a 15-year warranty service and maintenance agreement with Nordex Energy GmbH and a Nordex subsidiary in Ukraine as service provider. Traditionally, wind projects in Ukraine have been implemented under split contractual arrangements, separately for turbine supply on the one hand and installation and the balance of plant on the other hand. The Syvash project, however, benefits from a fully wrapped single point of contact EPC contract, thereby enhancing bankability.

To achieve this, NBT leveraged its deep experience of owning, financing and operating wind farms in China to select, and negotiate with, one of China’s largest EPC contractors, PowerChina. As such, the Syvash project is one of the few wind farm projects in Ukraine with an internationally recognised EPC contractor.

The historic reason for separating the EPC scope in Ukraine was due to the reluctance of turbine suppliers to take on liability for the supply and construction elements as a result of the inflexibility of Ukrainian construction law. In that regard, a construction company in Ukraine must have a construction licence and such licence requires the construction company to establish a local company.

An innovative solution was developed for Syvash where the EPC contractor would just establish a representative office in Ukraine, a permanent establishment, and obtain the construction licence in the name of such establishment.

The move to auctions

The parliament in Ukraine is in the process of adopting a new law under which the current FiT scheme will be replaced by auctions. According to the second reading of such law submitted on April 11 2019, auctions will be launched from January 2020 and will be conducted twice each year through the Prozorro electronic auction platform. The auction will be conducted as a one-stage, static, sealed-bid auction.

The bidders will submit closed bids containing a technical offer, capacity for which the bidder intends to obtain the right, and a financial offer, electricity price per 1 kWh. The price is the only criterion on which the winner will be selected.

The Ministry of Energy & Coal Mining of Ukraine will prepare a submission on quota size based on proposals of the transmission system operator and the State Agency on Energy Efficiency and Energy Saving of Ukraine. The annual quota size will be approved by the Cabinet of Ministers of Ukraine. The offtake contracts awarded from the auctions will be signed for 20 years and guaranteed by law.

The draft law provides for certain transitional provisions that will make projects under development eligible for the existing FiT scheme.

In order for the project to qualify for the existing tariff, in the relevant period it has to have land, a grid connection agreement, the relevant construction permits or a notification of commencement of construction works and a pre-PPA with Energorynok.

What this means is that while there is no doubt that the market’s response to the new auction scheme will be critical to the further development of the renewable energy sector in Ukraine, the FiT scheme will also be influential for some time to come.

Conclusion

The outlook looks bright for renewable energy projects in Ukraine. The Ukrainian authorities are working towards addressing the obstacles and complexities that have historically faced the sector.

The Syvash project demonstrates that foreign investors will commit to the market when presented with an attractive offering. There are enduring complexities but with a project such as this as a blueprint, opportunities can only increase. ■