

Change in Power: How New UAE laws may affect IPP and Solar Projects

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In the first quarter of 2018, we have witnessed a lot of activity involving power and water projects in the UAE. This article considers the recent activity, the existing legal framework and key legislative developments.

Power & Water Projects: Key recent activity

Leading examples of key recent projects and pipeline activity include:

- The Abu Dhabi Water & Electricity Authority (ADWEA) has announced its intention to invite bidders for a second solar power plant in the middle of this year;
- Dubai Electricity & Water Authority (DEWA) has awarded contracts to build a 40 million imperial gallons a day (MGD) desalination plant at Jebel Ali and for the fourth phase 815 megawatt expansion of the Al-Aweer H Station power plant;
- Financial close of the fourth phase of the Mohammed Bin Rashid Solar Park is expected to be completed in the first half of 2018;
- The Federal Electricity & Water Authority (FEWA) has issued a request for proposal in relation to a proposed 45 million MGD desalination plant Umm Al Quwain; and
- The Sharjah Electricity & Water Authority is also active in the planning of new power projects that will have private sector involvement.

This action is a continuation of trend in the UAE of the development of power and water infrastructure to meet future demand, diversifying the energy mix into new areas such as nuclear and renewables and greater private sector participation in the delivery of new assets.

Current legislative framework

ADWEA and Abu Dhabi have led the way involving the private sector in development of its power production capabilities since the introduction of Law No (2) of 1998 Concerning the Regulation of the Water and Electricity Sector, which introduced the independent power producer (IPP) model to the Emirate. Dubai introduced its own IPP regime via Dubai Law No. 6 of 2011. As a result of Abu Dhabi having undertaken the most IPP transactions the 'Abu Dhabi' model is looked to in practice as a basis for new greenfield transactions. This model provides government sponsors, project developers and financiers comfort that the broad framework of a transaction has been tested, implemented and accepted (or to use the industry term, is 'bankable').

Abu Dhabi and Dubai also have regulatory regimes for captive commercial and industrial (C&I) solar installations. These allow private businesses to generate solar power from panels installed on their premises for their own use with any surplus power feed back into the power grid with an offset against their power bills.

Notwithstanding the dedicated legal frameworks, many other aspects of UAE law impact on the development IPP and C&I solar projects. We now consider three developments under UAE law that could impact existing practice in this area.

Foreign ownership

At present, the Federal Law No. 2 of 2015 ("UAE Companies Law") provides that any company established

in the UAE (other than in free zones) must have one or more UAE partner holding at least 51% of the share capital of the company. The law only contemplates 100% foreign ownership in companies where there is either (i) a special federal law to that effect or (ii) a cabinet decision provides such an exemption.

In this area, UAE media has reported on announcements from the Ministry of Economy, as recent as October 2017, that a new UAE Federal Investment Law, which would allow 100% foreign ownership in certain sectors of the economy, is planned for 2018. It is not clear at this time which sectors of the economy would be covered under this proposed law but power generation could be a strong candidate with power distribution continuing to be the monopoly of the respective Emirate electricity & water authorities (EWAs).

In practice, the 51% local ownership requirement is met by the applicable EWA taking an ownership stake in the project company of an equivalent or greater share. IPPs are predominantly financed by a syndicate of financial institutions and can be significantly leveraged given the long-term and assured revenue generating nature of power assets. However, banks will not fully finance a project meaning the EWA must make a material equity contribution to fund the project. By allowing greater foreign ownership in the power generation sector, this would reduce the financial burden on Emirate governments and allow the private sector to assume the risk (it is estimated that the UAE plans to invest USD 272bn by the year 2050 to meet energy demand).

The IPP law in each Emirate has varying degrees of flexibility to allow for foreign ownership. For example, neither the Abu Dhabi or Dubai laws mandate a minimum local ownership requirement and the ordinary position in the UAE Companies Law implicitly applies. The Dubai law expressly contemplates that DEWA is to establish joint ventures with third parties without expressing what its ownership would be. In contrast, the Abu Dhabi law does not specify that a joint venture must be formed with an ADWEA company. The FEWA position is the same. As no minimum equity stake by the EWA is mandated, any relaxation under a UAE Federal Investment Law would make greater private sector involvement possible. IPPs in the UAE may become even more demand as the potential commercial returns increase to private investors.

In the C&I solar space, the Dubai and Abu Dhabi framework imposes specific local licensing requirements on the entity that carries out the design of C&I system and the contractor that carries out the works to construct and install the C&I system. Unless a foreign branch can be established, non-UAE entities that specialise in this area must establish a joint venture with a local partner. If a new UAE Federal Investment Law allowed 100% foreign ownership in this sector, greater foreign investment may also follow.

Movable Assets Security Law

UAE Federal Law No. (20) of 2016 on the Mortgage of Movable Property to Secure a Debt (“Movable Assets Security Law”) came into force on 16 March 2017. Broadly the Movable Assets Security Law does two things: it sets out a new regime for creation of security over movable assets; and it sets up a public security register for that security. Earlier articles in Law Update in Issues 296 and 303 have detailed the key changes and benefits that this law should bring to the UAE.

The particular impact it may have on IPP transactions is the potential for an “all assets” security under the Moveable Assets Security Law to replace the commercial business mortgage—a form of security contemplated by Federal Law 18 of 1993 (commonly referred to as the “Commercial Transactions Law”) which grants security over a commercial company’s existing tangible and intangible assets. The commercial business mortgage is not widely employed due to the cost and complexity of the perfection process. However, it is a standard feature of IPP transactions to ensure financiers are fully secured. Security under the Moveable Assets Security Law would have an equivalent scope to the commercial business mortgage but has the advantages of a low cost and simple registration process and “self-help” enforcement rights which commercial business mortgage does not provide. Of course, the Moveable Assets Security Law does not replace the existing methods. Therefore commercial business mortgages remain possible and a valid method to create security. Until the regulations for this law have been issued and the security register becoming operational, we expect the commercial business mortgage will

continue to be the security of choice for IPP transactions.

The Moveable Assets Security Law would also allow specific security to be taken over C&I solar equipment. This means C&I suppliers could supply equipment on deferred payment terms or financiers could provide dedicated lending for the acquisition of the equipment, better enabling customers to afford installation. The self-help remedies provided under the law give a new and distinct advantage that is not available under an ordinary pledge of goods under the UAE Civil Code, which requires enforcement via the courts meaning there is a significant risk of delay and diminution in the value of assets. Consequently under the Moveable Assets Security Law, suppliers or financiers should have the necessary tools to undertake rapid enforcement and the recovery and redeployment of assets. The law also permits registration of operating leases of movable assets that have a term of more than one year. Accordingly, where C&I solar equipment that is structured as an operational lease the interest can be registered and the lessor can take advantage of the enforcement provisions provided in the law.

Financial leasing law

It was announced in January 2018 that the UAE's Federal National Council approved a draft law regulating finance leases. We understand the law will apply to leasing of property that, at the end, provides an option for the lessee to acquire the property at the end of the lease. Information that it is publicly available on the law makes clear that the lessor will need to be licensed by the Central Bank of the UAE to undertake financial leasing activities.

The need for a licence from the Central Bank is likely to impact UAE businesses that lease equipment with a buy option included (for example in car leasing or C&I solar equipment). However, it may also provide new opportunities. For example, in IPP solar transactions the developer acquires the relevant solar panels and related gear. The developer could instead lease the equipment. Banks could also procure the necessary licence and become lessors of equipment, as an extension of their asset financing operations, in either IPP or C&I solar projects.

Once the law becomes public, it can be scrutinised further to understand its likely impact in this area and on other laws. For example, the law will need to be read together with the Movable Assets Security Law as there is a possibility for overlap given both laws deal with a party's interest in movable property (including by way of lease) and rights that arise as a consequence. We will publish a more detailed article on the law's content and its effect on the finance lease industry generally in the UAE when it is available.

Meet the new laws

Power and water infrastructure projects will continue to grow apace as the UAE looks to fulfil expected future demand. Current laws already allow bankable IPP and C&I projects to be implemented. However, the new laws planned, drafted or enacted mentioned in this article will further support implementation of new projects by providing greater opportunity for foreign investment and for deal and financing structures to evolve.

Mark Brown regularly advises lenders and power generation companies on projects in the UAE. For further information please contact Mark Brown (m.brown@tamimi.com).