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STRUCTURING AND DOCUMENTING A PUBLIC/PRIVATE INFRASTRUCTURE DEVELOPMENT PARTNERSHIP, THE PROJECT FINANCE MODEL

Theodore S. Boone
Arnold & Porter
Theodore_Boone@aporter.com

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A. The Form of the Public/Private Infrastructure Development Partnership.

- The form of public/private infrastructure development partnership which shall be examined is that of a privately owned single purpose economic unit functioning on the basis of a concession or license granted by a government (i.e., a "Project Company"). Such a concession or license if often granted by a government in an auction process. The Project Company is financed by limited recourse loans where the lenders to the Project Company look primarily to the cash flows and earnings of the Project Company as the source of repayment of the loans and to the assets of the Project Company as security for the loans (i.e. a "project financing").

- The project financing model has been used to develop, *inter alia*, telecommunications, energy and transportation infrastructure.

- The types of government concessions or licenses which might be held by the Project Company are, for example, a concession to build and operate a mobile telephone system, a power plant or a motorway.

B. Role of Guarantees.

- Project financings often involve undertakings or direct or indirect guarantees by third parties (the "Sponsors"). The Sponsors are often the owners of the Project Company.

C. Attraction of Project Finance for Sponsors.

- Because the Project Company is an entity separate from the Sponsors themselves, there is often no substantial impact on the balance sheets of the Sponsors or the creditworthiness of the Sponsors.

D. A Common Project Finance Loan Structure in Simplest of Terms.

- The Sponsors guaranty repayment by the Project Company of the debt owed by the Project Company during the Project Company's construction, development and testing stages. The construction, development and testing stages of an infrastructure project often do not result in significant revenue for the Project Company and are therefore the period of highest risk for the lender to the infrastructure project.

- The guarantee of the Sponsors falls away and is no longer enforceable when the project which is the focus of the Project Company is fully operational ("Completion"). Under this framework repayment of the loans after the guaranty falls away is linked to the success of the project and the assets of the project.

- Because the guaranty is no longer enforceable at "Completion" the definition and means of determination of what should constitute "Completion" is a key and often heavily negotiated feature of project finance Loan Agreement(s).

- Often used legal documentation for an infrastructure development project finance is summarized below.

E. Letter of Information.

- The Letter of Information is submitted by the Sponsors to the Lenders. It provides information on the Project Company and the infrastructure project, such as the ownership structure of the Project Company and financial projections for the project.

- A Letter of Information may contain certain representations and warranties concerning the Project Company and the Sponsors.

- The representations and warranties of the Letter of Information are usually reiterated in the Loan Agreement(s).

- If the Lenders decide to proceed with providing financing to the Project Company on the basis of the information contained in the Letter of

Information and subsequent discussions, the Lenders, the Project Company, the Sponsors and the government entity which issued the concession or license held by the Project Company proceed to negotiate and finalize the full package of legally binding agreements necessary for the infrastructure financing. This package is discussed below.

F. Government License or Concession Contract.

- The government license or concession contract is essentially the document granting the Project Company the right to undertake the project (e.g. to build and operate the mobile telephone system, power plant or motorway for a specified number of years and in a certain manner).

- The Project Company's government license or concession contract must be in a form satisfactory to Lenders. The Lenders will review the government license or concession contract closely since it is the basis on which the Project Company will operate.

- In particular, the provisions in the government license or concession contract which provide the government with the right to terminate the Project Company's right to operate (e.g. for failure to perform operations in conformity with certain standards) must be in a form satisfactory to Lenders.

- Termination of the government license or concession contract would result in a default by the Project Company of its obligations to the Lenders under Loan Agreement(s). In which case, the Lenders could be left with project assets and an incomplete project that would not be sufficient to cover the debt of the Project Company owed to the Lenders.

- Therefore, from perspective of Lenders, the possibilities for termination by the government of the government license or concession contract must be minimized and carefully regulated. In particular:

    - ➢ Events deemed to be non-performance of the Project Company should be kept to absolute minimum; and

    - ➢ The Lenders should receive prior notice of the possibility that the government might terminate the license or concession contract. The Lenders should also be provided by the government with an opportunity to participate in discussions regarding possible termination by the government of the license or the concession contract and an opportunity to work with the Project Company to cure the problem which could lead to termination.

G. Loan Agreement(s).

- Project Finance Loan Agreement(s) contain in part many of the same characteristics as standard loan agreements (e.g., the amount of the loan, the interest rate, the terms of repayment, and affirmative and negative covenants of the borrower). They also contain, however, certain provisions which are particular to the project finance setting. For example, because the guarantee of the Sponsors of the debt of the Project Company discussed above falls away at “Completion,” a clear and workable definition of “Completion” in Loan Agreement(s) is particularly important.

- Below for illustrative purposes is an example of a definition of “Completion” in the case of a mobile telephone system project financing.

- “Completion” means the milestone at which all the requirements set out below have been fully satisfied:

    - The mobile telephone network consists of no few than [________] lines which are ready for use;

    - The mobile telephone network equipment meets recommended performance standards and generally accepted standards within the telecommunications industry;

    - The mobile telephone network is capable of satisfying all technical and other requirements of the government mobile telephone concession such as geographical coverage and quality of service;

    - The portion of mobile telephone network consisting of [ ] lines has operated for a specified period at defined service quality standards;

    - The Project Company complies with sound health, safety and environmental standards and all applicable laws and regulations;

    - No Event of Default or Potential Event of Default under the Loan Agreement(s) has occurred:

    - The Project Company has reaffirmed the representations and warranties in the Loan Agreement(s) and the Sponsors have reaffirmed the representations and warranties in the Guarantees; and

- Certain financial tests for the Project Company (e.g., the Project Company's debt service coverage ratio) have been met.

H. Security Agreements.

- The Project Company and the Sponsors will pledge certain Security for the loans received by the Project Company from the Lenders. Under these arrangements, if the Project Company defaults under the terms of the Loan Agreement(s) the Lenders will be entitled to enforce their rights under the Security granted to them. Security granted to the Lenders to secure the debt owed to the Lenders by the Project Company may include:

    - A pledge by the Project Company of the governmental license or concession contract. A government is often reluctant to grant such a pledge;

    - A pledge of the shares in the Project Company held by Sponsors. This is often the most effective form of security as such a pledge if enforced by the Lenders allows the Lenders to obtain the shares, and therefore ownership and control, of the Project Company in the case of a default by the Project Company on its debt;

    - A pledge by the Project Company of all real estate owned by the Company;

    - A pledge by the Project Company of all movable assets owned by the Company;

    - A pledge by the Project Company of intangible assets, such as intellectual property and contractual rights;

    - An agreement by the Project Company to transfer its receivables to the Lenders in the case of a default of the Project Company under the Loan Agreement(s); and

    - An assignment by the Project Company to the Lenders of insurance proceeds received by the Project Company after a default of the Project Company under the Loan Agreement(s).

- The government must also grant its permission for the Project Company and the Sponsors to pledge the Security and to enforce step-in and substitution rights; i.e., - rights which enable the Lenders to „step-in" and run the project or appoint a new project company to run the project should a major default by the Project Company occur.

- The relationship between the enforcement of security and any minimum local ownership requirements for the Project Company stated in the government license or concession contract need be addressed. For example, the government license or concession contract might specify that at least 25% of the Project Company be locally owned. In such a case, Lenders might seek an exemption to this local ownership requirement in the case of the Lenders exercising their "step-in" rights.

- The taking of Security is often primarily defensive – i.e., it prevents a third party from acquiring rights in security in priority to Lenders.

Security Sharing Agreement.

- The Security Sharing Agreement will be between the Lenders. It will providing for a pari passu sharing of Security as between the Lenders.

Share Retention Agreement.

- The Share Retention Agreement is an agreement between the Lenders and Sponsors under which Sponsors undertake to retain their shares in the Project Company until loan is repaid. This agreement provides the Lenders with assurances that the ownership of the Project Company (and therefore control of the Project Company) will not change so long as the Lenders' loans are outstanding to the Project Company.

Guarantees.

- Guarantees are also often called "Project Completion Agreements" or "Project Funds Agreements." Types of guarantees include:

  - A straight guarantee by Sponsors of payment of amounts due under the loan of the Lenders until Completion; and

  - A commitment by the Sponsors to provide all necessary cost overrun and support necessary so that Completion is achieved.

A key issue in this area is whether the Sponsors' guarantees should be "capped" at a specified amount. If the guarantees are not capped the Sponsors may be heavily exposed if the project runs into severe difficulty. However, the existence of caps may be unsatisfactory to the Lenders.