

OZMINE 2011

Legal Perspectives in Project Finance

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Summary

Section 1: Project finance parties and documentation

Section 2: Key legal issues in project financing

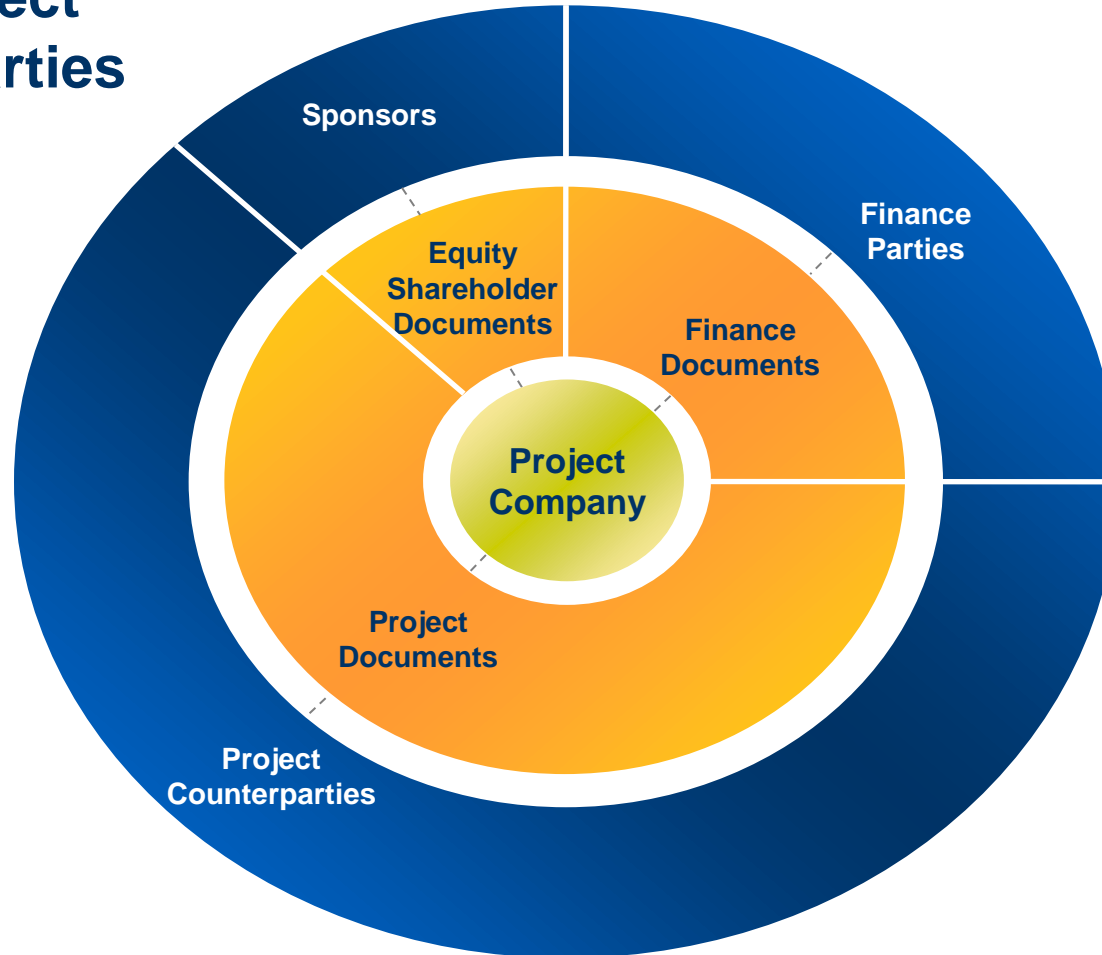
Section 3: Risk assessment

Section 4: Risk allocation and mitigation

Section 5: Structure and security

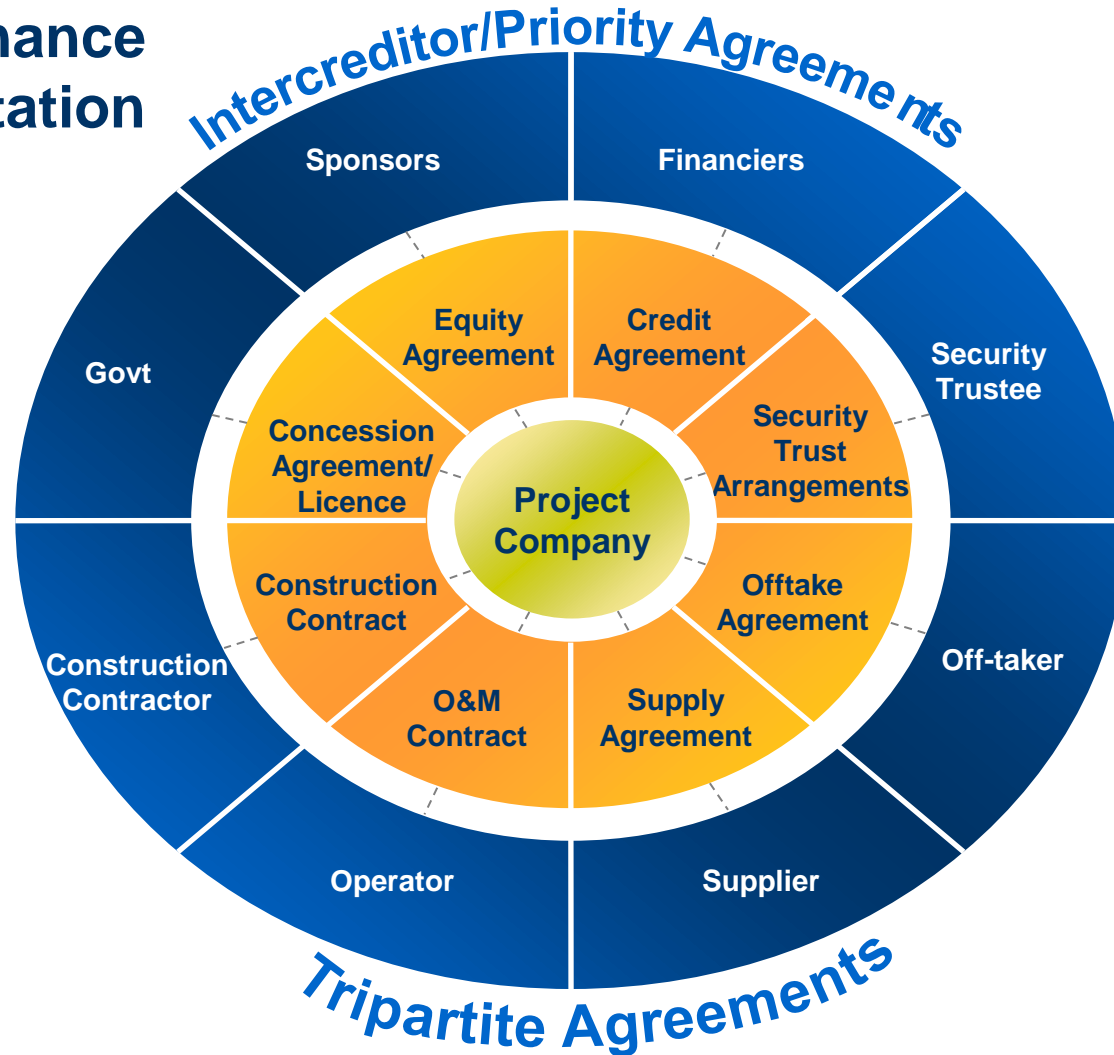
Section 1: Project finance parties and documentation

Major project finance parties (PFPs)



Section 1: Project finance parties and documentation

Project finance documentation



Section 1:

Project finance parties and documentation

Bottom line...

- **At the beginning of a project financing:**
 - Financiers have the money
 - Project developers (e.g. Project Company and Sponsors) have the experience
- **By the end of a project financing:**
 - Project developers have the money
 - Financiers have the experience

Section 2:

Key legal issues in project financing

- **Risk assessment**

- **Key question:** What are the risks in the project?
- **Bottom line:** is the project “bankable”?

- **Risk allocation and mitigation**

- **Key question:** Which PFP will accept those risks?
- **Bottom line:** How can those risks be mitigated?

- **Structure and security**

- Do the above risks affect project financing structures?
- What other factors affect project financing structures?
- What security issues affect project financings?

Section 3: Risk assessment

*“If you want to make money you have to
take risks”*

Anonymous

Section 3:

Risk assessment

What is risk assessment?

- All PFPs undertake risk assessment in some form or other
- For financiers risk assessment is central to “bankability” of any project financing
- Risks are a moving target which will be dependant on:
 - nature of the project
 - country in which the project is to be undertaken
 - legal systems applicable to the project

Section 3:

Risk assessment

Common risks

- **Completion risk:** failure to construct/complete the project
- **Technology risk:** inadequacy of project technology
- **Cost overrun risk:** cost overrun/delay in project completion
- **Business risk:** failure in Project Company's operational or business functions
- **Political risk:** political instability or interference in the project
- **Patronage risk:** failure to attract target market for the product/end result of the project
- **Change of law risk:** changes affecting viability or cost of the project (e.g. environmental and tax law)

Section 4:

Risk allocation and mitigation

“The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning.”

Charles Tremper

Section 4:

Risk allocation and mitigation

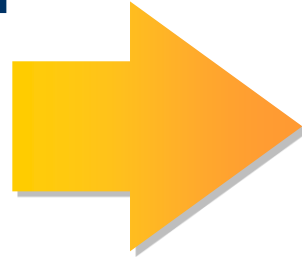
- **Principle:** Risk allocation **should** be made according to capacity, experience and involvement in the project
- **Reality:** Risk allocation **is actually** driven by market precedent and the differing and often conflicting motivations of each PFP



Section 4: Risk allocation and mitigation

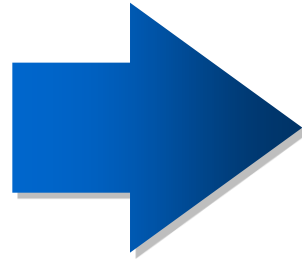
Common risks: mitigation

How do financiers
discover risks?



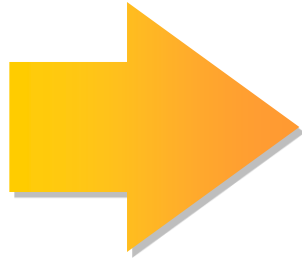
Due diligence

Completion risk



Liquidated damages
Performance bonds
Sponsor support
Insurance

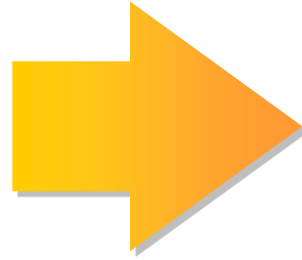
Technology risk



Due diligence
Supplier guarantees
Sponsor support

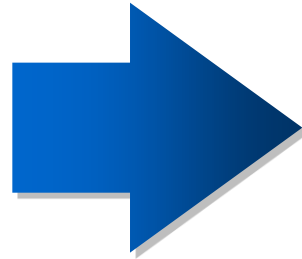
Section 4: Risk allocation and mitigation

Cost overrun risk



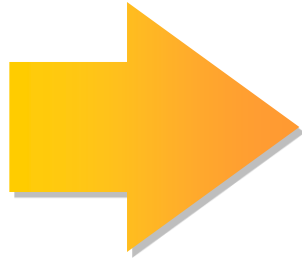
Sponsor support
Fixed price contracts
Cost overrun facility

Business risk



Covenants
Insurances
Operator replacement
Control accounts

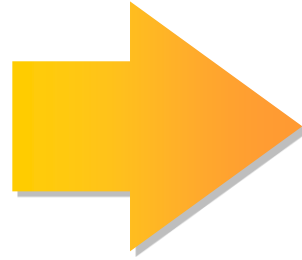
Political risk (**PR**)



PR insurance
ECA financing
Indemnities

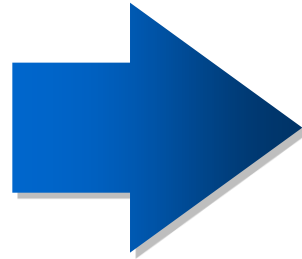
Section 4: Risk allocation and mitigation

Patronage risk



Long-term supply
contracts

Change of law risk

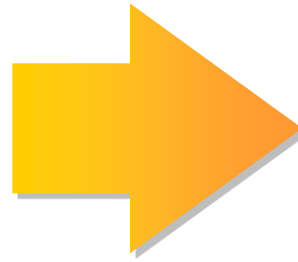


Restructure/refinance

Section 4: Risk allocation and mitigation

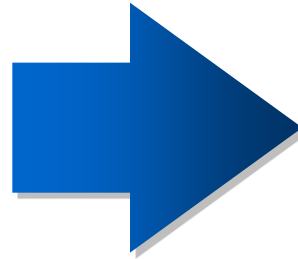
Other risks: mitigation

Land risk



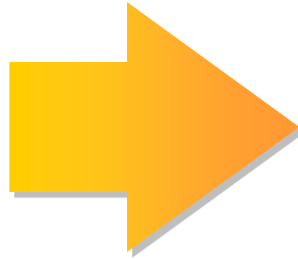
Not negotiable

Force majeure (**FM**) risk



Insurance
Consistent FM clauses

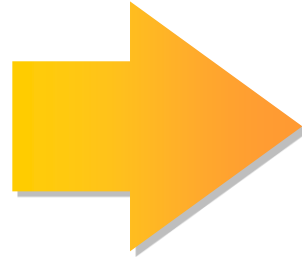
Price/off-take (**OT**) risk



Long-term OT contracts
Futures contracts
Hedging arrangements

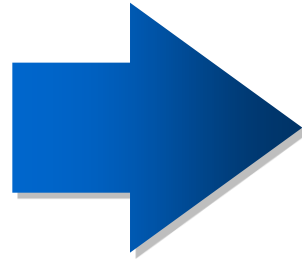
Section 4: Risk allocation and mitigation

Currency/ interest rate risk



Hedging arrangements

Insolvency risk



Due diligence
Covenants
Trigger events

Section 5: Structure and security

*“Beware of over-confidence; especially in
matters of structure”*

Cass Gilbert

Section 5:

Structure and security

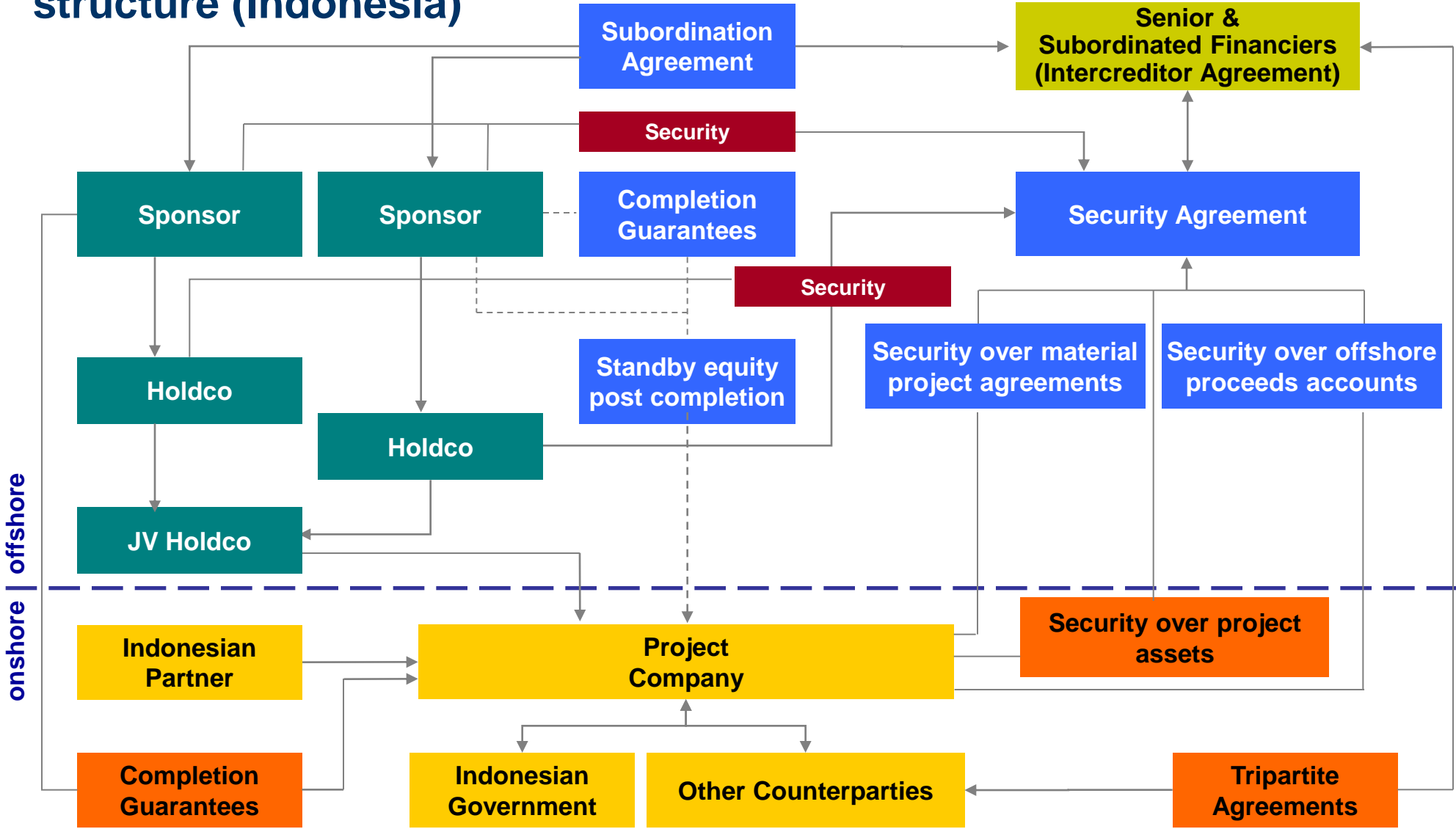
How does risk affect structure?

- Certain risks can be mitigated within existing documentation
- Otherwise, structuring may offer some solutions to risk
- However, structuring cannot always mitigate risk fully

Other issues affecting structuring

- Ensure a tax efficient structure for the project
- Manage local law ownership and divestment issues
- Deal with security issues
- Prevent other PFPs or even third parties from interfering with the project or project assets

Example project finance structure (Indonesia)



Section 5:

Structure and security

What are security issues?

- Key issues:
 - Can security be granted over key project assets?
 - What is the proper form of that security? (e.g. mortgage, pledge, charge, etc.)
 - How effective is that security and how quickly, easily and cost effectively can it be enforced?
- If problems arise, can offshore security be taken:
 - to mitigate against an inability to take/enforce onshore security ?
 - to subvert lengthy, risky or costly onshore enforcement proceedings?

Section 5: Structure and security

Tripartite Agreements (also known as Direct Agreements)

- Instrument through which financiers:
 - gain rights to receive notification defaults (e.g. potential risk events)
 - are able to lock down parties through anti-assignment clauses and anti-amendment clauses
- Protects value of contractual rights secured by security instruments by allowing financiers to:
 - *theoretically* control competing “step-in” rights of Government
 - suspend enforcement/termination rights of other PFPs
 - “step-in” and cure Project Company defaults

Questions?

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