

***The Fundamentals of
Project Finance***

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- What Does It Take to Succeed?
- Global Economic Environment
- Securing Funding for Projects
- Obstacles to Obtaining Financing
- Potential Solutions to Financing Obstacles
- Key Contractual Issues
- Project Risks
- Defining Contract Terms
- Conclusion

■ Project Team

■ Consortium Members

- Look for Synergies
- Need to have a well defined joint venture agreement
- Local / Industrial Partners
- Creativity (Project Structure, Financing)
- Inclusion of Equipment Manufacturer / Fuel Supplier

■ Potential Issues

- Competing interests within group
 - Foreign vs. domestic (tiering issues for tax treatment)
 - Project Company vs. equipment or fuel supplier

■ Project Team

■ Legal Advisors

- Past host country deal experience is **CRUCIAL** for success
- Need to know the process already rather than “learn as you go”
- Experience fast tracks development and financing timelines
- Require that the “Face Team” be the “Deal Team”
 - Include Requirements in Engagement Letter
- Local counsel selection is KEY

■ Financial Team

- Utilize relationship lenders
- Financial advisor / Lender combination
- Prepackage requirements as much as possible
 - Remember 75 page “*Term Sheet from Hell*”

- Project Team:
 - Cultural Sensitivity (International Markets)
 - CRITICAL to a project's success
 - Local partners are a great asset
 - Language skills will streamline deal and reduce costs

- Keys to Success:
 - Teamwork
 - Patience
 - Creativity

- Projects Compete Globally for Available Financing
 - Documentation needs to be prepared with Lenders in mind
 - Include place holders for Lenders' Rights
 - Reference obligation to execute Lenders' Consent
 - Provide for obligation by contract parties to cooperate with financing
 - Lenders are comparing Relative Risks and Returns on a global basis
 - Current Infrastructure Lending Community is more Conservative

■ Available funding sources

■ Equity

- Consortium Members
- Private Investment Funds

■ Debt

- Private Sources
- Commercial Banks
- Pension Funds

■ Government Sources

- Export/Import Credit Agencies
- Bilateral/Multilateral Development Agencies

- **CONSIDER Inclusion of World Bank Guidelines and JBIC, CABEL or FMO requirements in documentation**

- Cost Factors
 - Market Volatility
 - Existing credit exposure of specific lending institutions
 - Pricing based on country or off-taker credit rating unless project sponsors are willing to provide some guarantees

- Select financing sources familiar with Issues
 - Issues are extremely similar among Projects
 - Hold a beauty contest (interview candidates regarding their approach to specific issues)
 - **Potential Problem:** Some institutions familiar with particular regions/sectors may have already reached their country/sector credit exposure cap

- Local Market Volatility

- Concerns over Devaluation

- Legal Regulatory Frameworks

- Increasing Environmental Concerns relating to Infrastructure Projects
 - International Standards being imposed on local markets

PRICING ADJUSTMENTS

- Pricing Adjustments in Project Documentation need to be permissible on a current basis
 - Example: Brazilian Law (Real Plan) limits how frequent adjustments may be made
 - In order for the market to work correctly, consumers must pay for the actual energy production costs (remember California)

- Some Pricing Adjustment mechanisms may be difficult to enforce
 - Economic Equilibrium concept

Potential Solutions To Financing Obstacles Morgan Lewis

- Seek International Consultants Early in the Process
 - Structure Projects with the International Lending Market in mind
 - Address Lenders' Concerns Early
 - Retain Attorneys Specializing in Project Finance (region specific)
 - Retain Potential Lenders as Financial Advisors

- Seek International Partners
 - Gains project access to more lending sources (JBIC, US Eximbank, FMO, CABELI, DEG)

- Risk Identification, Allocation and Mitigation
- Basic Commercial Terms
- Macroeconomic and Political Issues
- Legal and Regulatory Issues

- Revenue Stream
 - Payment Risk
 - Escrow Accounts
 - Lock Box Accounts
 - Creditworthiness of Customers
 - Potential Substitute Customers

- Concession / Franchise
 - Revocability
 - Exclusivity

- Technology
 - Market Acceptance (Proven Track Record)
- Completion
 - Experience of EPC Contractor
 - Provide Proper Incentives for EPC Contractor
 - Early Completion Bonus (if Owner gets additional revenues)
 - Liquidated Damages
 - Sharing of Cost Savings
 - Performance Bonuses
- Environmental
 - Existing Conditions
 - Controlling Public Relations is **KEY**
 - Evolving Environmental Consciousness of Region
 - Build with the future requirements in mind

- Site
 - Suitability for Intended Purpose
 - Archeology

- Supply
 - Potential Pool of Substitute Suppliers in the Event of a Default
 - Crucial Issue for Fuel
 - Full Indemnification for Delivery Failures

- Management

- Operation
 - Experience of Operator
 - Provide Proper Incentives for Operator

- Force Majeure
 - Crucial to Specifically List Covered Events
 - All Project Documents need to “dove tail” each other
 - Relief Period should cover Effects of Event (rather than “day-for-day” extensions)

- Economic Conditions
 - Changed Economic Conditions (Unexpected / Drastic)
 - Price Reopeners
 - Consider Deadbands
 - Inflation Considerations

- Political Stability (Example: Venezuela)

- Demand for Product
- Regulatory Regime
- Legal System
- Currency Availability / Convertibility

- Buyer / Seller

- Description of Product or Service – Scope

- Quantity
 - Replacement Obligations
 - Take-or-Pay Liability

- Price – Amount, Currency, Terms

- Quality
 - Right to Reject
 - Acceptance with Price Adjustment
 - Replacement Obligations

- Period of Delivery (Term of Contract)
 - Conditions Precedent
 - “Financing Out”
 - Extension Options
 - Force Majeure Extensions

- Default - Non-performance and/or Risk Allocation
 - Cure Periods
 - Replacement Rights (Project Agreements)
 - Cross Defaults

- Remedies - Consequences of Non-performance or Default
 - Termination
 - Penalties
 - Replacement Obligations

- Force Majeure – Consequence of Uncontrollable Events
 - Natural Events
 - Government Actions
- Indemnities – Consequence of Third Party Harm
 - Negligence versus Gross Negligence Standard
 - Third Party EEs under Supervision
- Assignment
 - Financing Considerations
- Dispute Resolution, Choice of Law
 - Senior Management Discussions
 - Mediation
 - Independent Engineer Resolution for Technical Issues
 - Arbitration

- Term
- Compensation – Cost vs. Incentive
- Scope of Work
- Staffing
- Performance Standards
- Authority of Operator

Defining Contract Terms (Supply Contracts) Morgan Lewis

- Delivery Terms
 - Delivery Point and Title Transfer
 - Transportation
 - Insurance

- Seller Creditworthiness

- Bifurcated Structure

- Onshore Construction Contract
- Offshore Supply Contract
- Coordination Agreement (Key Document)

- Benefits

- Tax Savings for Contractor and Owner
- Allows EPC Consortiums to be formed in Background

Defining Contract Terms (JV Arrangements) Morgan Lewis

- Voting
 - Majority Issues
 - Veto Rights
 - Unanimous Issues
- Buy Down / Buy Out Provisions
- Dispute Resolution
- Capital Calls
 - Dilution of Interests
 - Shareholder Loans
- Assignments to Third Parties
 - Right of First Offer (Partners presented deal 1st)
 - Right of First Refusal (Partners have right to match offer)
 - Due diligence costs for 3rd Parties is a consideration
- Exit Strategy ***IS KEY***

- Identify, Mitigate and Allocate Project Risks
- Clearly Define Goals
- Know Your Exit Strategy



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Dino T. Barajas is a partner in the Corporate Practice Group of Morgan, Lewis & Bockius LLP. Resident in the Firm's New York and Los Angeles offices, Mr. Barajas has extensive experience representing lenders, investors, and developers in a wide range of domestic and international project financings in the energy, power, infrastructure and commercial sectors, as well as traditional banking, structured finance, mergers and acquisitions, corporate finance, asset finance, joint ventures and venture capital. His clients include commercial lenders, institutional investors, investment funds, project sponsors and public and private companies. Mr. Barajas has worked on transactions in Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guam, Guatemala, Honduras, Mexico, Nicaragua, Peru, Trinidad & Tobago, the United States, Yemen and elsewhere.

Mr. Barajas was recognized by *California Lawyer Magazine* as "**Attorney of the Year (Energy)**" in 2004. The Xacbal power project in Guatemala, for which Mr. Barajas was counsel to the sponsor, was recognized by *Latin Finance Magazine* as "**Latin American Energy/Power Deal of the Year 2007**". The Rio General power project in Costa Rica, for which Mr. Barajas was counsel to the sponsor, was recognized by *The Bank Magazine* and *The Financial Times Group* as "**Deal of the Year (Costa Rica) 2007**". Additionally, *Project Finance Magazine* awarded the Tuxpan V Project and the Altamira II Project in Mexico, transactions for which Mr. Barajas was lead attorney, the "**Latin American Deal of the Year (Power) 2004**" and the "**Latin American Deal of the Year (Power) 2002**", respectively. The Choloma III Project in Honduras, for which Mr. Barajas was lead attorney, was first runner-up for the "**Latin American Deal of the Year (Power) 2004**". Mr. Barajas is recognized (one of only three California lawyers) in *The International Who's Who of Project Finance Lawyers, 2005 (3rd Edition)* and 2007 (4th Edition) for his accomplishments and is recognized by *Chambers & Partners USA* as a "**Leader in the Field of Project Finance**" in 2006, 2007 and 2008. Mr. Barajas is a member of the State Bar of California. He received his J.D. from Harvard Law School and holds a Bachelor of Arts degree summa cum laude in Communication Studies and the Business Emphasis Program from the University of California, Los Angeles. Mr. Barajas is fluent in Spanish.