

CROSS-BORDER CONTRACTS IN THE ENERGY SECTORS

Multi-Source Project Financing Strategies



Mohit Saraf, Partner
Email: msaraf@luthra.com
Delhi | Mumbai | Bangalore

INTRODUCTION

BANKABILITY OF A PROJECT

- **Infrastructure Projects- very few become a reality**
- **Projects fail – mainly because of bankability issues**
- **Need to understand what makes project bankable to appreciate**
 - **Lenders' rights**
 - **Lenders' recourse**

NON-RECOURSE/LIMITED RECOURSE CONCEPT

- **“Limited Recourse” Project Finance v. Corporate Finance**
- **Limited recourse to Project Participants**
- **Project SPV**
- **Full recourse to Project Assets and Project Contracts**

PROJECT FINANCING

- **Long term commitments of participants: Debt servicing period**
- **Allocation of risk to parties that can best manage it**
- **Cash flow of the Project is critical: Market/Offtaker**
- **Risk varies from participant to participant and over time**
- **Projects seldom enjoy rating above sovereign rating**

IDENTIFYING AND MANAGING RISKS

PROJECT RISK AND MITIGATION

- **Construction Risks:**
 - Turnkey fixed price and fixed term contract
 - Performance Guarantees and Warranties

- **Operation Risk:**
 - O&M (Bonus, penalties)

- **Payment Risk:**
 - Offtake Agreement/Third party sales
 - Payment security mechanism

- **Market Risk:**
 - Feasibility report/market study

PROJECT RISK AND MITIGATION (contd.)

- **Sponsor equity support, non-disposal and cost over run undertakings**
- **Matching of contracts**
 - **Monitoring through financial ratios, Information rights**
 - **Insurance- third party liability, business interruption**
- **Adherence to Project standards & specifications**
- **Good Industry Practices**

PROJECT RISK AND MITIGATION (contd.)

- **Step-in rights & substitution rights**
- **Assignability of Project contracts**
- **Direct and Consent Agreements**
- **Trust & Retention Account**
- **Standard waterfall**
 - **Tax**
 - **O&M**
 - **Working Capital Lenders**
 - **Project Finance Lenders**
 - **Reserve Account**
 - **Equity**

POLITICAL/LEGAL RISK & MITIGATION

- **Change in law & Change in tax: Compensatory clauses**
- **Critical consents and approvals (EIA clearance; RBI/ FIPB Approval): CPs**
- **Country risk- Sovereign Rating/ adverse balance of payments etc.**
- **Force Majeure: Excuse & Payment**
- **Insurance; Commercial and Political Risk cover from ECAs**
- **Foreign governing laws for contracts**

PROJECT FINANCE: OTHER FEATURES

- **Concessions regulate creation of security**
 - **Prior approval of governmental bodies**
 - **Security may not be created over certain essential project assets only step in rights**
 - **Security may be created only in favour of certain class of project lenders**

- **In PF Lenders have an interest in continuity of the Project**
 - **receivables, as opposed to physical assets, constitute the bulk of value.**

INTER-CREDITOR ISSUES

BALANCING EXERCISE

- **Any project financing involves a number of lenders that have different objectives**
- **For example, Senior Lenders and Working capital lenders have different roles and security**
- **Their rights also differ both contractually as well as legally**
- **Need to balance the rights of different types of lenders**
- **It raises issues with respect to waterfall, security creation and enforcement**

DOMESTIC AND FOREIGN LENDERS

● **Lending, and Creation of Security**

- **Foreign Exchange Regulation- ECB Guidelines (end use, all in cost ceiling); Pledge of shares etc.**

● **Enforcement of Security**

- **Foreign Exchange Regulations (RBI approval for repatriation)**
- **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Securitisation Act)**
- **Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act)**

DOMESTIC LENDERS DRT ACT

- **Debt Recovery Tribunals**
- **Notified Banks and Financial Institutions**
- **Application to Tribunal by banks upon default in debt (secured/unsecured)**
- **Order of Tribunal enforced through Recovery officer**
 - **Attachment and sale of movable or immovable property**
 - **Appointment of receiver for management of property**
 - **Arrest and detain the defendant**
- **Appeal to Appellate Tribunal (75% deposit)**

DOMESTIC LENDERS SECURITISATION ACT

- **Provides for enforcement of security interest by notified banks and financial institutions without judicial process**
- **Enforcement upon**
 - **Default in payment of Secured Debt**
 - **Account is non-performing**
- **May enforce security interest after serving notice (sixty days):**
 - **Take possession of secured assets**
 - **Take over management of the business**
 - **Appoint manager for the secured assets**
 - **Transfer by way of lease, sale etc.**

FOREIGN LENDERS

- **Foreign banks/financial institutions that do not transact the business of banking in India**
 - **benefits under the Securitisation Act or the Debt Recovery Act not available**
- **Notification as a banking company/ financial institution by the Central Government**
- **Disparity between legal remedies of notified domestic lenders and that of foreign lenders**
- **Trust arrangement –Domestic creditors hold in trust amounts received for the benefit of foreign creditors as well**

OTHER INTER-CREDITOR ISSUES

- **Voting arrangements- Majority ; Super Majority (2/3rd, 3/4th); Unanimous**
- **Enforcement mechanism and information & co-ordination- pro-rata sharing on recovery or prescribed priority**
- **Subordination- project sponsor debt**
- **Subrogation of Lenders**
- **Standstill period to preserve rights upon default**