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KIEV ARBITRATION DAYS 2015

Structuring an International Infrastructure Project

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The Lenders' Perspective

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Infrastructure Projects

Basic systems and services of a country

- Transportation
 - Highways, bridges and tunnels
 - Railroads, subways, MRTs
 - Harbours
 - Airports

- Communication
 - Telecommunication
 - Cables

- Energy
 - Power plants
 - Transmission networks
 - Pipelines

- Community
 - Water supply
 - Sewage
 - Healthcare
 - Schools
 - Prisons
 - Strong public interest
 - Vital importance for community
 - Many natural monopolies
 - Frequently operated by government
 - In part regulated
 - In part heavily subsidized
 - In part no commercial element
 - In part financed by the treasury
 - In part subject to fees based on availability or use

Infrastructure Projects

Basic systems and services of a country

- Most projects are located in one single jurisdiction
 - Highways, bridges and tunnels
 - Subways, MRTs
 - Water and sewage
 - Healthcare
 - Harbours, airports
 - Schools, prisons

 - Cross border projects involve several jurisdictions
 - Highways, bridges and tunnels
 - Railroads
 - Pipelines

 - Some projects are located in the High Sea or in one or more exclusive economic zones
 - Pipelines
 - Cables
 - Offshore energy
- Involvement of the government
 - Different levels (central government, provinces/states, municipalities)
 - Monopoly or dominance of state operators in many sectors
 - Specialized authorities
 - Close co-operation with other government functions
 - Regulators
-
- Involvement of several governments
 - Bilateral or multilateral treaties
 - Agreements on administrative level
 - International law aspects
-
- Involvement of one or more jurisdictions
 - Law of the High Sea
 - Limited sovereignty in EEZ
 - Further aspects of international law

Infrastructure PPPs

Key Drivers

- The budget perspective
 - Mobilization of private funds
 - Reduction of public indebtedness
 - Immediate revenues for the treasury
 - Long term revenues

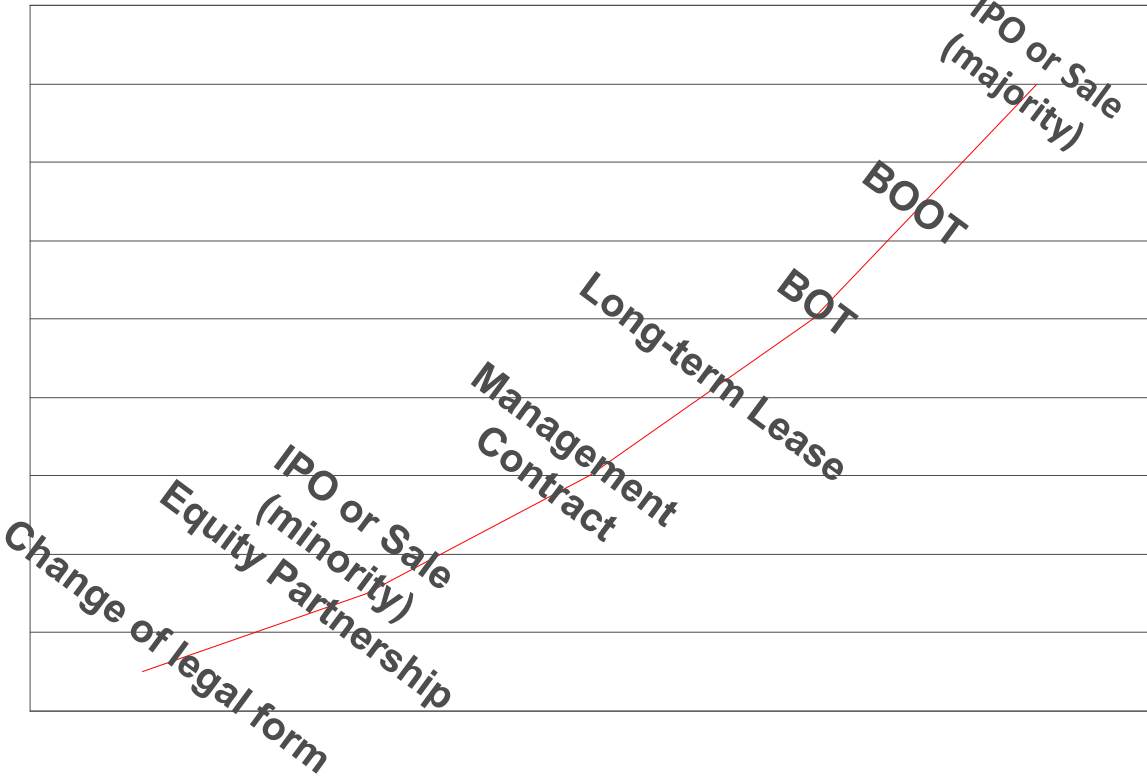
 - The project perspective
 - Raising funds to finance investments
 - Creating self-sustaining units
 - Bundling and cross-subsidies
 - Private sector efficiencies
 - Allocation of risks
 - Quality assurance
 - Transfer of technology

 - The community perspective
 - Boosting development
 - Creation of employment opportunities
 - Social and environmental impact
- Long term policy or dire need?
 - Cutting expenditures
 - Repayment of debt
 - Contribution to a stable budget
 - Long-term sustainability
-
- Equity
 - Debt
 - Project revenues
 - Concession fees
 - Availability-based?
 - User-fee based?
-
- National / regional / local interests
 - Co-ordinated planning?
 - Competition among infrastructure facilities
 - Additional jobs or transfer of public servants into private entities?
 - Tax revenues

Infrastructure PPPs

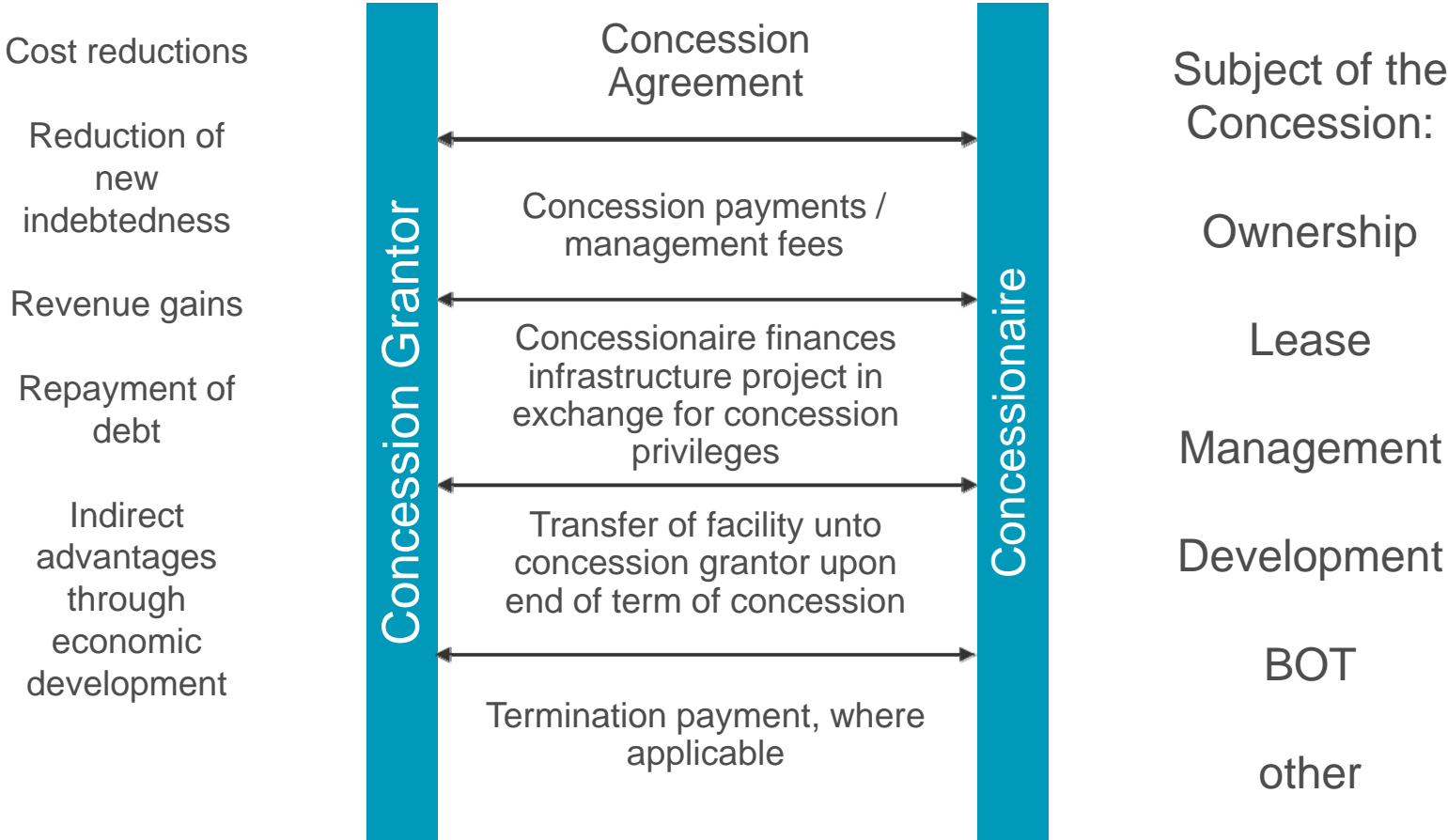
Selected Privatization Options

- Privatization of
 - Legal form
 - Operations
 - Ownership
- Temporary or permanent?
- Loss of public control ?
- Progressive privatization schemes



Infrastructure PPPs

The Financing Function of a Concession



Infrastructure PPPs

Harmonising Public Interest and Business Considerations

- Understanding public utilities as enterprises
- Allow the use of proceeds for other than public purposes (return to investors)
- Accommodate lenders requirements to facilitate bankable investment structures
- Reduce level of public control
- Deregulate public utilities economics
- Legal certainty / sanctity of contracts

Key concerns of sponsors and lenders

Key concerns of the public

- Maintain regulatory powers where appropriate
- Safety and security
- Investment undertakings
- Maintenance
- Service standards
- Transfer of employment relationships
- Environmental issues
- Continued operation even in case of bankruptcy
- Emergency powers

Infrastructure PPPs

Harmonising Public Interest and Business Considerations

- Rights of other stakeholders
- Stakeholder approvals and co-determination rights (e.g. for certain uses of revenues or for fee increases)
- Relation to other service providers, operators of related facilities or services
 - Highway fuel stations
 - Airport retail concessionaires and service providers
 - Joint use of railway tracks by different operators
 - ...
- Interface with government functions (regulators, supervision, police powers)
- Fair competition
- The mine field of cross subsidies

Mitigants for public interest concern-related business risks

- Flexible formulae for regulated fees
- Flexible formulae for mutual payment streams
- MAC provisions
- Risk allocation, risk sharing and cost sharing
- Contract re-openers
- Early termination events and termination payments
- Fair compensation for temporary or permanent government takings

Other important concerns where interest may be partially aligned or adverse

Infrastructure PPPs

Access to Finance

- Sources of Finance
 - Equity
 - Mezzanine
 - Senior Debt
 - Multilaterals (as lenders or investors)
 - Co-financing schemes
 - Project revenues

 - Types of Investors
 - Knowledge investors
 - Finance investors
 - EPC contractors
 - Government agencies
 - Stakeholders
 - Free float

 - Type of Debt Finance
 - Access to the capital market?
 - Private placements
 - Bank finance
- Getting the right investors
 - Concession requirements / eligibility criteria
 - Financial model
 - Profile of revenues and expenses
 - Debt equity ratios
 - Other financial ratios (DSCR, ...)
 - Foreign exchange regime
 - The role of guarantees
-
- Long-term focus?
 - Clear exit options vs. share retention
 - Transferability
 - Alignment and conflicts of interest
 - Foreign ownership restrictions
 - Foreign management/control restrictions
 - Level of private control
-
- Senior project bonds
 - Second ranking instruments
 - Corporate finance
 - Project finance

Infrastructure PPPs

Composition of the Lenders group

- Commercial Lenders
 - Play a key role in the building of a lenders syndicate
 - Are at the core of most finance structures
 - Multilaterals and development banks
 - May greatly contribute to the access to finance because of strong relations to host governments
 - Provide advocacy and good services in times of a crisis
 - May act as equity providers, lenders and/or advisers
 - International lenders
 - May provide financial strength and experience
 - Local lenders
 - Deeper understanding of local requirements
 - May contribute strong relations to the government
 - May represent a visible local interest in the project
- Commercial facilities
 - Facilities guaranteed by ECAs
 - export credit or
 - direct foreign investment schemes
 - Involvement of more than one ECA or multilateral not uncommon
 - Limited flexibility based on guidelines and policies
 - Provide comfort to commercial lenders
 - Regulatory constraints may influence the architecture of a syndicate
 - Intercreditor agreement in case of different lenders groups
 - Complex regime of representations and warranties, covenants, undertakings and events of default
 - Different lenders groups may have different requirements
 - Compliance with international standards

Infrastructure PPPs

Risk Allocation and Bankability

- Bankability starts with due diligence
 - Identification of risks
 - Financial
 - Demand / Market
 - Technical
 - Safety
 - Environmental
 - Regulatory
 - Legal and Tax
 - Foreign exchange
 - Concessionaire
 - Sponsors
 - Political
 - Country
 - and of their possible impact
- Identification of mitigants
 - Can the risk be avoided / controlled?
 - Who can best control the risk?
 - Which mitigants are available?
 - Who can best control the mitigants
 - Availability of insurance
- Risk reduction / prevention strategies
- Allocation of risks
 - The Party best suited to control / mitigate a risk should bear it
 - Regulatory framework for risk allocation
 - Existing contract structures
 - Policies
 - Market standards and expectations
 - Banks don't take project risks
- Impact on pricing
- Risk sharing for force majeure and other extraordinary risks

Infrastructure PPPs

Revenue Schemes

- Availability-based
 - Payments by a public authority based on the availability of services
 - The role of performance criteria

 - User-based
 - Payments by users based on actual use
 - Lease arrangements, e.g. with retailers and service providers

 - Mixed and other schemes
 - Cost sharing schemes
 - Subsidies
 - Official development assistance
 - Complex development schemes
- Independent power producer projects with public authority as off-taker
 - Demand risk taken by public authority
 - Social infrastructure projects
 - Other project that do not generate (sufficient) revenues or where private investors do not take demand risk, or where use cannot be efficiently measured
 - Private Finance Initiative (PFI) Program
 - Usually defined in detail in concession agreement
-
- Telecommunications, toll roads, railways, power, gas, water, ports
 - (Large) airports, e.g.
 - Passenger fees
 - Airline fees
 - Retail concessions etc.
 - Regulated and unregulated fees
-
- Risk sharing
 - Secure basic revenue stream
 - User-based payments for excess delivery
 - Combining more than one project

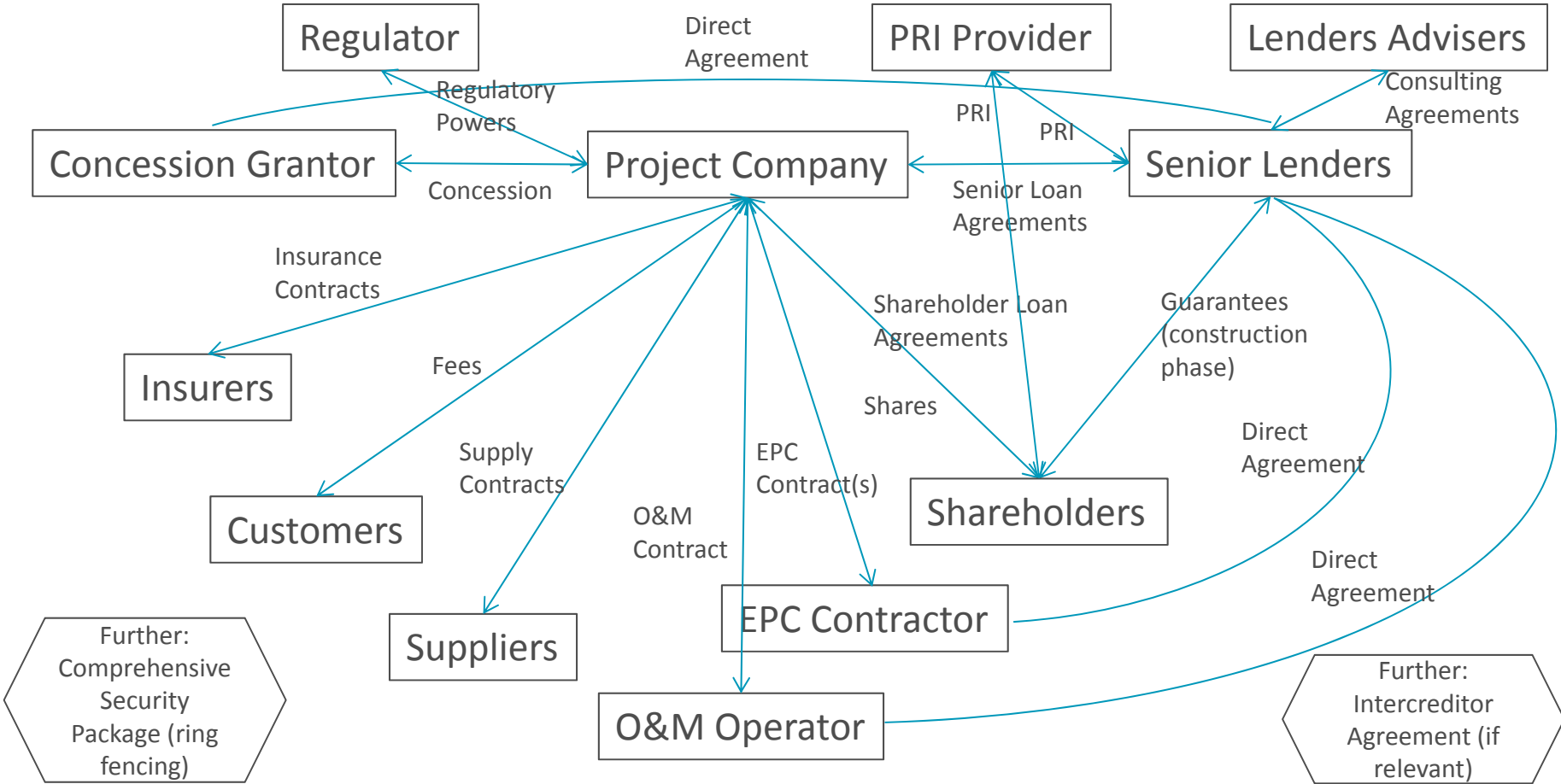
Infrastructure PPPs

Concession Fees Schemes and Termination Values

- Concession fee structure and robustness of contractual arrangements
 - Upfront fees
 - Sculpted, fixed or formula-based lease / concession payments
 - Sharing of particular revenues
 - Sharing of gross revenues
 - Profit sharing
 - Exit payments
 - Differentiation depending on cause of early termination
 - Default of concessionaire or concession grantor?
 - Force majeure event?
 - Predefined exit scenarios
 - Damages regime
 - Lender protection / equity protection / yield protection
- Impact of fee structure on
 - financial model and
 - interest of concession grantor in a long-term sustainable project
 - Correlation with investment requirements
 - Impact of regulated fees
 - Parametric formulae
-
- Considering the responsibilities for the occurrence of an early termination event
 - Fair allocation of burden
 - Compensation for investments made
 - If based on default, right of the non-defaulting party to claim damages
 - Burden sharing in case of force majeure
 - Various degrees of protections for lenders and equity investors
 - Budgetary constraints in many jurisdictions

Infrastructure PPPs

Typical Contract Structure (example)



Dispute Resolution

Amicable Negotiations and Litigation / Arbitration

- Negotiations
 - Most conflicts can be solved in amicable negotiations
 - Experience of local players and knowledge of international standards
 - No undue influence from pressure groups or vested interests
 - Important role of multilaterals or ECAs

 - Integrity and efficiency of dispute resolution
 - Access to court and independent court system
 - Alternative dispute resolution
 - Access to an international neutral forum?
 - Execution of foreign judgments / arbitral awards
 - International investment protection
- Most PPPs depends under numerous aspects on the co-operation of the concession grantor
 - Repudiation of contracts and legal proceedings may result in a forced renegotiation
 - But negotiations may be the only efficient way towards a win-win solution
 - Procurement law constraints
-
- Experience and reliability of the judicial system
 - Duration of court proceedings
 - Duration of ADR proceedings
 - Costs of international arbitration
 - Confidentiality aspects
 - Ability to agree on ADR may be restrained
 - Enforceability

Political Risk Insurance (PRI)

Eligibility and Subject of Cover

- In case of official ECAs: requirements depending on relevant ECA; Typical eligibility criteria include
 - Nationality requirements regarding the investor
 - Existence of bilateral investment treaties or equivalent protection
 - Worthiness of support / national interest requirements
 - Environmental impact criteria (OECD Common Approaches as guideline)
 - Reasonableness of risk
 - Multilateral standards (e.g. OECD Guidelines for Multinational Enterprises)
 - Corresponding regulatory framework for eligible export loans
- In case of private insurers: great flexibility subject to regulatory requirements and internal risk assessment
 - Cover may also be available for countries / risks for which no official ECA cover is available
- Investment type cover – official ECAs
 - Subject of cover depending on relevant ECA
 - A typical scope of cover would include
 - Direct investments (shares, partnership interests, endowment capital, participatory loans, other eligible assets of value)
 - Limitation to new direct investments not uncommon
 - Returns on investments (dividends, interest on covered loans and equivalent returns)
- Export credit type cover – official ECAs
 - Subject of cover depending on relevant ECA
 - Typically cover for loans against certain economic and political risks
- Subject of cover – covered risks
 - Many official ECAs offer only general coverage – some ECAs offer also tailored coverage against specific risks
 - Great flexibility as regards scope of covered risks in the private insurance sector

Political Risk Insurance (PRI)

Co-ordination among Finance Arrangements and PRI, Advocacy

- Finance documentation must comply with PRI requirements
 - Meeting eligibility criteria for covered loans
 - Compliance with obligations under PRI cover
 - Co-ordinated approach to avoid conflicts among the security arrangements of the lenders and security requirements of the PRI provider
 - Allowing subrogation of PRI provider (or equivalent arrangements)
- Risk mitigation by lenders
- Taking security over PRI cover for DFI
 - Assignment of rights or mere loss-payee?
 - Procuring compliance by beneficiary of cover with obligations under PRI cover
 - Preservation of corporate existence of beneficiary in loss event
 - Preliminary payments and claw backs
 - Allowing subrogation of PRI provider (or equivalent arrangements)
- Official ECAs: effective support in pre-claim situations
 - Official ECAs maintain close contacts to governments
 - Involvement in negotiations with government of host state (directly or via own government)
 - Leverage with many host state governments/ political dimension of claims
 - Experience shows that losses can be avoided as a result of government involvement
 - Prospects of success may depend on relations with host state
- Prosecution of claims post-compensation
 - Subrogation in case of compensation by an official ECA
 - Or co-operation in the prosecution of claims
 - Cost participation in court and arbitration proceedings
 - Sharing of recoveries
 - Blacklisting of host state governments in loss events if dispute remains unresolved

Bilateral Investment Treaties (BITs)

Scope of Protection

- Protecting private investments by nationals of one state in another state (foreign direct investments)
- Broad variety of treaties from different eras and different parts of the world
- BITs today involve most countries in the world
 - The first BIT: Pakistan-Germany BIT dd. 25 November 1959
 - Presently approximately 3,000 BITs in force
 - BITs are collected and archived i.a. by the ICSID
 - Certain countries (e.g. the USA, Germany) have developed Model BITs
- Due to an increasing number of cases a considerable body of precedents has developed
- Under the Treaty of Lisbon the responsibility for BITs was transferred from the EU Member States onto the EU
- Typical BIT protections include, *inter alia*,
 - Rules for promotion and admission
 - Fair and equitable treatment
 - Protection against arbitrary and discriminatory measures
 - Full protection and security
 - Protection from unlawful expropriation (including measures tantamount to an expropriation)
 - Rules for fair compensation
 - Free transfer of returns, sales proceeds and compensation
 - National treatment
- Many BITs further provide for
 - Most-favoured-nation (MFN) treatment (subject to carve-outs)
 - Umbrella clauses
- Dispute resolution
 - Disputes among a contracting state and an investor of another contracting state or between contracting states
 - ICSID, UNCITRAL, ICC, LCIA, Arbitration Institute of Stockholm Chamber of Commerce

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Structuring an International Infrastructure Project

The Lenders' Perspective

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