October 17, 2006

BAKER & MCKENZIE

東京青山・青木法律事務所

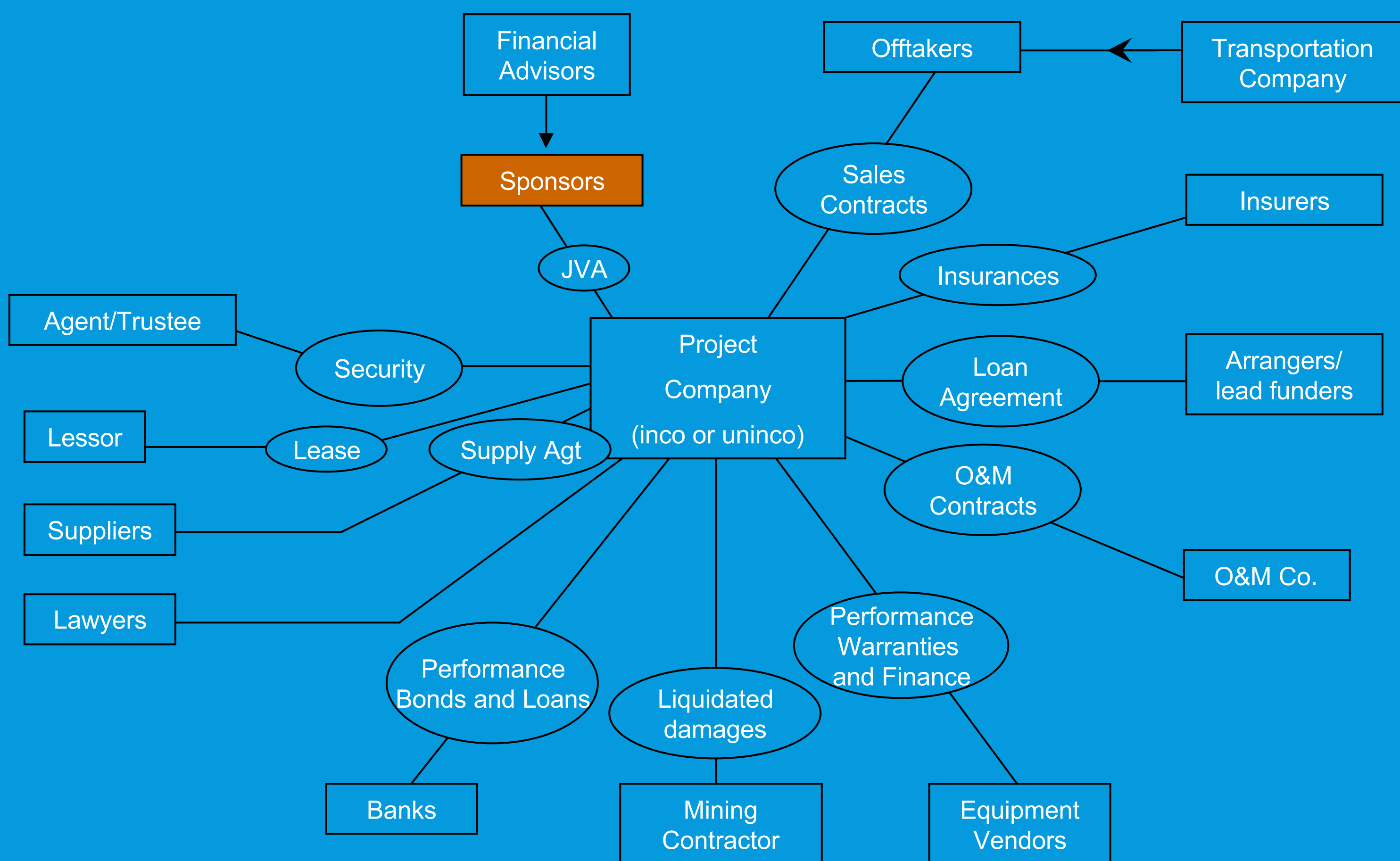
The Impact of Project Finance on Sponsors

Anne Hung, Partner

Email: anne.hung@bakernet.com / Tel: 03-5157-2710

Baker & McKenzie
東京青山・青木法律事務所

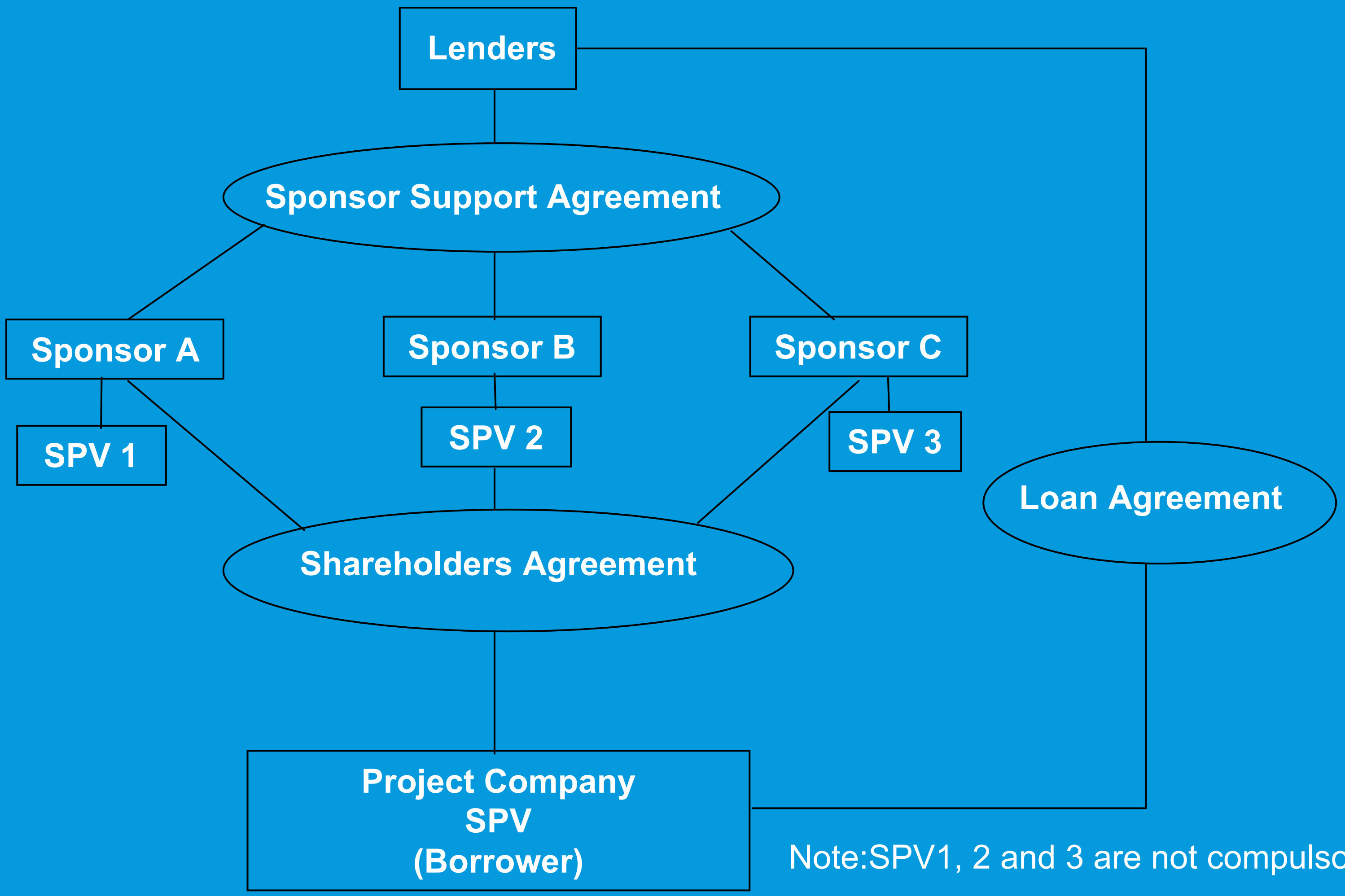
Typical Players in Project Financing



Participation Alternatives

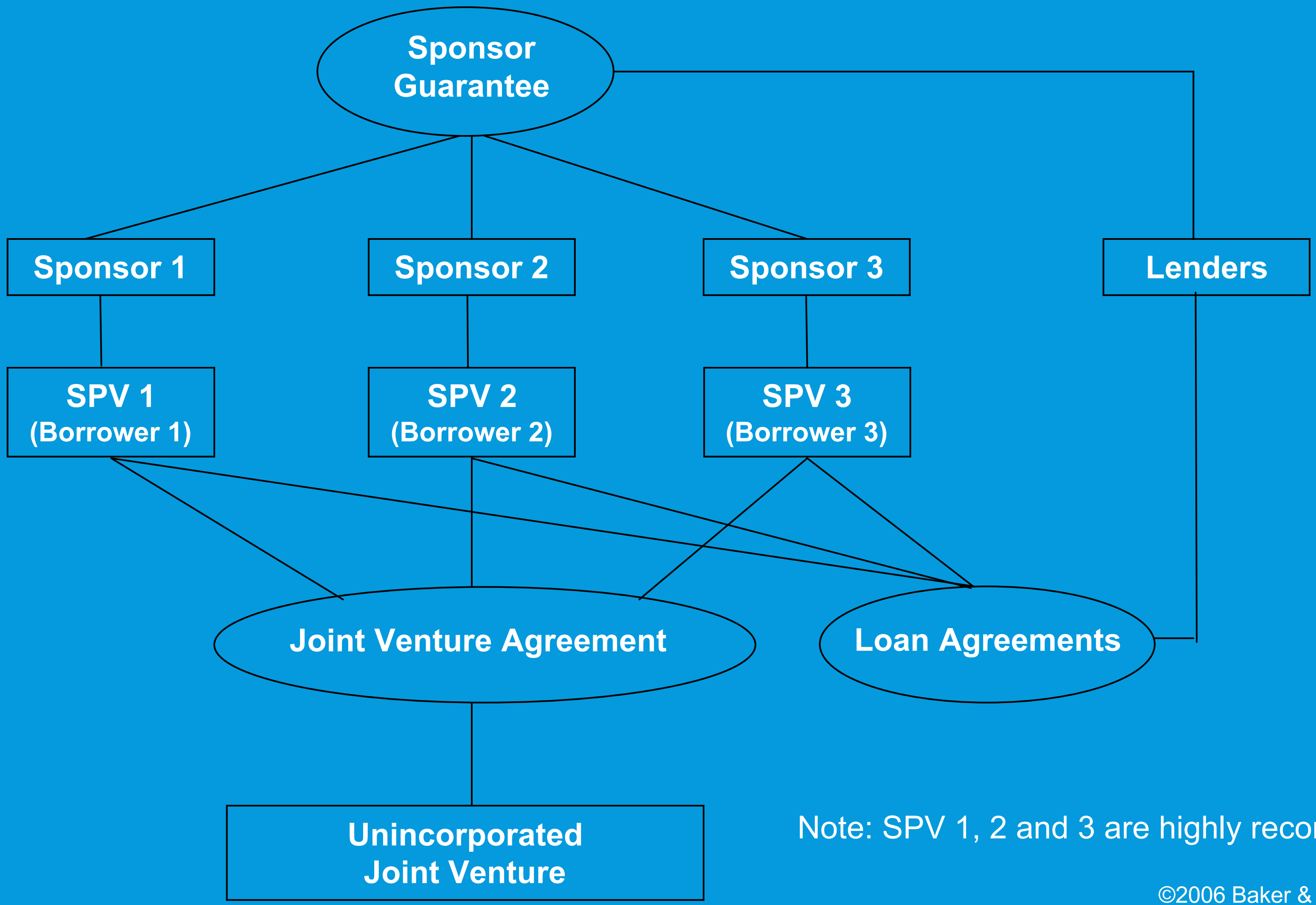
- As a sponsor (if borrower is an incorporated joint venture or if financier requires certain support from borrower's parent)
- As one of the borrowers with other joint venture parties in an unincorporated joint venture project
- As a financier with an option to convert loan into equity (one way to get into the project instead of upfront investment)
- As a competing creditor (because of cross charge)
- As a third party contract party (e.g. O&M provider) or an offtaker (to provide project revenue)

Incorporated Joint Venture



Note:SPV1, 2 and 3 are not compulsory

Unincorporated Joint Venture



Note: SPV 1, 2 and 3 are highly recommended

Incorporated Joint Venture

- A sponsor is not directly involved in the borrowing
- Single borrower
- Therefore sponsor is usually only a party to the Shareholders Agreement and the Sponsor Support Agreement and collateral documents

Unincorporated Joint Venture

- A sponsor is directly a borrower (usually through its SPV)
- Multiple borrowers therefore needs an "Operator" to hold it altogether
- Sponsor's SPV is a party to the Joint Venture Agreement Loan Agreement and sponsor itself is a party to the support and security documents

I. Typical Sponsor Issues

1. Types of Support from Sponsors

Unincorporated Joint Venture

- mandatory prepayment in loan agreement
- undertaking to pay Called Sum

Incorporated Joint Venture

- equity contribution
- reserve contribution
- completion guarantee
- fee guarantee
- repayment support

Note: sponsor support may be paid to borrower or lender - Question of whether Trustee should have control over funds that should go to borrower.

2. Minimum Credit Criteria of Sponsors

- Sponsors may be required to provide security to back up their support
- can be in the form of
  - cash
  - letter of credit
  - bank guarantee
  - parent guarantee
- Different sponsors financial situations may result in different backing ⇒ may become a point of conflict

3. Upper Limit

- Limited recourse
- Need to confirm cap applies to each type of supports
- Best if cap can be reduced as project progresses, especially if L/C or bank guarantee is required.
- Beware of claw back provision if it requires sponsors to make additional payment despite of cap, for example, at time of bankruptcy.

4. Failure to Perform by Another Sponsor

Unincorporated Joint Venture

- Usually several and not joint but “operator’s” obligations usually apply to all borrowers
- Problem – if operator is owned by one borrower

Incorporated Joint Venture

- a breach by a sponsor under a sponsor support agreement is a cross default under the Loan Agreement which in turn will trigger the other sponsor’s support

5. Restrictions on Internal Restructuring

- sponsors usually invest through offshore structure
- should retain maximum flexibility in financial documents in case future internal restructuring is required
- difficult and time consuming to seek lenders consent after documents are signed (require majority approval)
- lenders may use the opportunity to ask for more security
- lenders should be satisfied if “ultimate” holding and sponsor support remain unchanged
- need own legal counsel to focus on this issue

6. Pre-emptive Right / Anti-dilution Clauses

- Alteration or suspension of certain rights under the Joint Venture Agreement is often required by lenders

  Uninco ⇒ appear in loan agreement or deed of priority

  Inco ⇒ appear in sponsor support agreement
- Anti-dilution and restrictions on sale clauses are justifiable because they affect the value of the lenders security
- Pre-emptive right is less clear
  - direct conflict position between lenders and sponsors
  - one of the most important protection for sponsors
  - lenders feel that pre-emptive right imposes a restriction on sale that could reduce the value of the asset
  - if one sponsor is in default, the other sponsors (not in the capacity as borrower) should have pre-emptive right
  - most lenders accept to respect pre-emptive right but may try to impose other restriction such as consent, sponsors need to act together to resist such restriction.

7. Completion Guarantee

- Requires sponsors to repay the loan in full if completion is not achieved / or to put in whatever money to get the project completed
- Avoid sunset date for completion as an event of default
- Completion test – a lot more difficult in mining and upstream oil and gas projects than in plant projects because no machine to test performance, test may include level of operating costs and revenues

II. Typical Borrowers Issue

- If more than 1 Borrower – need to confirm no cross default
- Role of operator – is it a mere messenger?
- Cross default among borrowers
- Mandatory Prepayments – such as cash flow sweep, financial covenants (debt service cover ratio, reserves cover ratio)
- Any shareholders support requirements
- Any completion guarantee requirements by borrowers
- Cash flow waterfall – try to obtain distribution as early as possible
- Definition of Completion
- Event of Default - any sunset date for completion, any financial covenants restrictions

III. Sponsor Acting as Lender First

- Financing proceeds in parallel with an option to convert loan into equity or with other agreements desirable by lenders
- Needs to have in place joint venture documentation in order to exercise option
- Powerful position as both financier and sponsor usually can obtain very favorable terms
- Can control the project through approval requirements financial reporting, change in control restriction, event of default clauses
- Advantage of receiving repayments before other sponsors and creditors (depends on security)
- Cross default with other agreements important to lender

IV. Typical Competing Creditors Issue

- Typically all shareholder loans are subordinated.
- Competing priority between JVer's rights in cross charges vis a vis lender's securities
- Cross charge is the security given by a sponsor over its interest to the other sponsors
- Cross Charge is usually accepted to rank ahead of the financier's securities and documented in a Priority Deed
- Need to consider carefully what is the scope of the cross charge to maximise the priority. E.g.
  - Does the cross charge target the whole of SPV of other sponsors or only venture assets (raise the issue of whether sales proceeds are covered – competing with financiers)
  - Does it only covers failure to pay called sum or should it be broader and covers all defaults under JVA

V. Typical Third Party Contractor

- **Lenders may require Direct Agreement:**
  - Acknowledgement of security interest
  - Representations
  - Default notice
  - Suspension of termination rights – how long?
  - Step-in period – allows lenders to remedy defaults
  - Step-out
  - Novation – should third party contractor has a veto