WHO'SWHOLEGAL

Roundtable: Project Finance 2014

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Who's Who Legal brings together Karen Wong of Milbank Tweed Hadley & McCloy, Filipe Lowndes Marques of Morais Leitão Galvão Teles Soares da Silva & Associados, Robin Abraham of Clifford Chance and Jaime Herrera of Posse Herrera Ruiz to discuss levels and types of project financing, the trend for energy projects, the impact of government investment on the sector, regulatory developments and changes in the legal market in their jurisdiction.

Participants

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USA

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Portugal

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Jaime Herrera
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Colombia

***WWL:** After several years of risk-avoidance and hesitancy to lend on the part of European banks, some sources have seen signs of an increase in lending for large-scale projects, with cautious optimism for 2014. Is this something you have observed in the domestic or international market, and what alternative methods of project financing have been successful over the past year?*

Karen Wong: Thomson Reuters reported that project finance in the Americas for the first quarter of 2014 – with US$14.1 billion of transactions – marked the largest first-quarter volume on record in the Americas, as well as the highest growth for the period, representing a 75.2 per cent uptick from the first quarter of 2013.

The Thomson Reuters league tables for the first quarter of 2014 demonstrate that a number of European banks have increased their lending for large scale projects in the Americas in the past year.

Regarding alternative methods of project financing in the commercial bank market in the US, there have been a number of capital markets transactions, term loan B transactions, bank-bond deals, leverage lease transactions and securitisation transactions. We have also seen a number of private equity firms forming funds to provide debt and tax equity financings. However, one recent phenomenon and a popular, innovative alternative to project financing that is currently on the rise has been the "yieldco" initial public offering (In 2013, a new type of investment vehicle, now commonly referred to as a "yieldco" went public. A yieldco operates similarly to a master limited partnership (MLP) but possess contracted renewable and conventional generation and thermal infrastructure assets, but which do not qualify for "MLP" status). Companies such as NRG, Pattern Energy, Brookfield Renewable Energy Partners and Hannon Armstrong have successfully raised financing through initial public offerings of common stock in yieldco vehicles involving their portfolio of renewable projects.

On 30 April NextEra filed its plans with the US Securities and Exchange Commission to launch a public offering for a yieldco in the renewable energy sector, and both SunEdison and Abengoa are in the midst of preparing for their announced yieldco offerings. In addition, in recent large multibillion-dollar project financed transactions, such as Cheniere's Train 3 and Train 4 of the Sabine Pass Liquefaction Project, where the Export-Import Bank of Korea (KEXIM) and the Korea Trade Insurance Corporation (K-SURE) provided $1.5 billion of the $5.9 billion financing, and the subsequent Cameron and Freeport LNG projects in which Japan Bank for International Corporation (JBIC) is providing its support, we expect to see the increased role of export credit agencies as Korean, Chinese, Japanese and European companies look to invest in or have agreed to provide construction services to large US infrastructure projects.

Filipe Lowndes Marques: It appears that Portugal seems to have weathered the storm, and although recovery will no doubt take its time, we are optimistic that the worst seems to be behind us. Recent movements in the market seem to confirm this fact, as several new projects, which had been mothballed for some years, are now reappearing, with local banks available to provide financing at viable rates for sponsors. In the last few years borrowers and banks have looked at alternatives to classical project financing structures, such as project bonds or leasing arrangements, although it is fair to say that the majority of deals follow the traditional model.

Robin Abraham: Yes, we have certainly seen a growing appetite among European-based banks to finance projects in the Middle East. Inevitably those projects with strong sponsors or ECA support tend to be the ones that attract the most liquidity. There is also a lot of regional liquidity competing with the international banks, particularly in Saudi Arabia, Qatar and the United Arab Emirates.

We're not back to the pre-2008 market but there is an upwards trend – and more optimism than there's been for a while. We also expect to see an increase in project bonds, in particular, to refinance completed projects, which should free up some bank liquidity for new projects.

Jaime Herrera: For a couple of years now, Colombia has enjoyed a relatively isolated local investment environment, albeit with ongoing political processes, the internal conflict and international economic turmoil. A conservative economic management of inflation, public deficit and employment levels have turned Colombia into a stable and, to many, attractive investment destination.

Infrastructure projects, namely transportation (road concessions, airports, river transportation, etc) and energy projects have been at the forefront of project finance developments. Energy projects, including hydro and gas power generation projects, have been active throughout the years – insofar as they have been built over a robust legal and regulatory framework dating back from the early 1990s. However, the development of renewable energy mega projects (ie, steam, wind, thermal and solar) has not reached its all-out potential. Renewable projects are perceived as back-up facilities to the more conventional hydro or gas generation projects. Existing government incentives available to power generation renewable projects do not offset discrete profitability levels resulting from high development costs, coupled with intermittent availability and dispatch.

In any event, the local financial system has been ahead of the curve in assuming financing of projects. We are yet to see a more active role from European banks in the upcoming set of projects.

***WWL:** Energy projects, particularly in the renewables arena, have been popular targets for investors over the past year due to the rising demand for energy infrastructure in light of economic growth and urbanisation in emerging markets. Have you been actively advising clients in this area over the past year, and where do you think the key jurisdictions will be for such projects over the coming year?*

Karen Wong: Milbank has been active in renewables for the past two decades, and accolades received in 2013 include being named the Top Legal Adviser For Clean Energy Project Finance and Top Legal Adviser for Clean Energy M&A by Bloomberg New Energy Finance, the *Chambers* Award for Excellence in the area of energy/projects, the Legal Adviser of the Year Award at the Euromoney and Ernst & Young Global Renewable Energy Awards, Best Law Firm for Renewable Energy Finance by *Environmental Finance* and *Carbon Finance* magazines, and Top-ranked Power Legal Adviser and Renewable Legal Adviser by *Infrastructure Journal*.

Milbank continued to see strong activity in the US renewable sector last year, with wind and solar being most active. This year there is continued activity in the wind sector with the financing of projects, which commenced construction before the end of last year – taking advantage of the expiring production tax credit – and the solar sector being very active. This is because of the 30 per cent investment tax credit that is available for projects that are placed in service by the end of 2016.

In the first quarter of 2014, Milbank has closed a number of renewable energy project financing transactions, including representing Google in its recently announced investment with SunPower Corporation to create a programme to help homeowners finance residential solar projects, and in its tax equity investments in a portfolio of solar projects acquired by KKR from Recurrent; Union Bank in its tax equity investment in Rockland's Lakeswind Project; the lenders in FirstWind's Route 66 Wind Project; the lenders in Pattern Energy's Panhandle 2 Wind Project; CPV in its Keenan II Wind Farm; and LS

Power in the financing related to the acquisition of 11 hydroelectric power stations by its subsidiary, Harbor Hydro Holdings LLC, from FirstEnergy Corp.

Although the production tax credit is only currently available for new wind projects that commenced construction prior to the end of 2013, there is optimism that the US federal government will likely extend this tax benefit before the year is over. With long-term fixed power purchase pricing falling to as low as $45–$55 per MWh in recent power purchase agreements under negotiation and the investment tax credit sunsetting soon, a number of utilities have issued RFPs for solar projects or recently signed solar project power purchase agreements which will provide for a pipeline of new deals. While the US market continues to be active, we see growth opportunities in Latin America (particularly Chile) and Japan, as well as the Middle East and Africa.

Filipe Lowndes Marques: As a result of the downturn and the tightening of bank lending in the Portuguese market, very few renewables projects have been greenlit in the last couple of years. During that period we have been involved in several repowering transactions where additional capacity was added to existing projects, as well as the few wind farms, photovoltaic plants and biomass plants that still went ahead. There does seem, however, to be grounds for optimism as several mandates for new wind farm projects have been granted in the first few months of 2014, which indicates a strong return to this source of renewable energy.

Robin Abraham: There is lots of interest in renewables in the Middle East, and we've been busy advising clients on wind and solar-related projects in the Middle East over the last 12 months.

The major development in the Middle East market over the past year has been the announcement by Saudi Arabia of a very ambitious renewable energy programme. In February 2013, Saudi Arabia announced plans to procure 54gW of renewable energy by 2032 through King Abdullah City for Atomic and Renewable Energy (KA CARE), an independent body established by royal decree to develop Saudi Arabia's atomic and renewable energy programme. While at this stage KA CARE has not generated much work for the project finance market, there is a lot of interest and great potential.

Other countries in the region have also indicated an interest in renewables, to varying degrees, including Kuwait, Jordan and Oman. In the UAE, the Dubai Electricity and Water Authority has also announced an agreement to build a solar power plant in Dubai.

Jaime Herrera: Just recently we have been discussing with clients the possibility of developing certain solar and thermal generation projects. There are certain ongoing studies relating to the feasibility of renewable energy projects in the southern part of the country. But, as mentioned, the perception is that relatively high development and technology costs are not addressed by focused government incentives or subsidies that would otherwise step up profitability levels. This is made more pervasive if one considers that Colombia has abundant hydrological resources; to such extent, it is my perception that the regulation of renewable energy projects is not currently high on the regulatory agenda of the government.

***WWL:** A key factor in steady project finance activity over the past year has been the renewed willingness of governments to invest in public infrastructure with long-term, large-scale schemes boosting the sector in countries such as Hong Kong and Brazil. Can these examples act as a model for encouraging investment in other jurisdictions where financing is slow, and is there a risk of over-reliance on government spending for new projects?*

Karen Wong: The role of governments in boosting public infrastructure is definitely a model for encouraging investment in jurisdictions where financing is slow and that is a model that has proven effective in many jurisdictions, including the US. After the financial crisis in 2008, the US government's adoption of the American Recovery and Reinvestment Act in February 2009 spurred activity in many sectors, including the renewable energy sector. Among the benefits in the stimulus packages was the adoption of the Section 1603 cash grant incentive, which provided for a cash payment equal to 30 per cent of eligible grant property to be paid to power project developers of qualifying renewable energy projects (ie, solar, wind, biomass, incremental hydroelectric, fuel cells, combined heat and power, geothermal, landfill gas, microturbines, marine hydrokinetic and municipal solid waste projects). This incentive was a particularly powerful enabler of many renewable energy projects that previously depended on an extremely thin tax equity market to monetise the federal tax credits. In fact, the Department of Energy reported that as of 1 November 2013, the cash grant incentive programme was responsible for 91,871 new renewable energy projects, representing 27.9 GW of generation and a US$19.8 billion investment by the US government. Although the Section 1603 cash grant programme has expired, activity levels have remained reasonably robust in the renewable energy sector in 2014, based on the extensions of the production tax credit for wind projects commencing construction as of the end of last year and the continuing availability of the investment tax credit for solar projects that are placed in service by the end of 2016. Without the availability of the cash grant, the renewable energy market has seen a return to the need for traditional tax equity investors for projects involving sponsors who are unable to directly utilise the federal tax benefits and are dependent on finding tax equity investors.

Over-reliance on government spending has definitely hampered the growth of the US renewable energy business, which has over the past two decades, in many respects, become reliant on federal tax incentives to be competitive with thermal resources. The boom-bust cycle is evidenced each time legislation providing tax incentives is expiring and is not renewed or such renewal is delayed.

Filipe Lowndes Marques: It may be argued that Portugal's strong investment in public infrastructure during the "boom" years under PPP structures was part of the reason it found itself in a difficult economic position in 2008. Several projects that were launched were hard to justify economically and have been having serious revenue issues, which has meant added dependence on the state. The current government appears to recognise the importance of investment in public infrastructure so long as such infrastructure is viable and has recently published a discussion paper on vital essential infrastructure projects for the next five years, with a high emphasis on railways and ports, which may also help attract international banks back to the Portuguese lending market.

Robin Abraham: A key characteristic of projects in the Middle East has been the strong levels of government support, whether through grants of land, fuel resources, guarantees or equity in project companies. However, I would not say that there is a risk of over-reliance, at least in the Middle East, because government support goes a long way towards making international banks and ECAs comfortable in providing financing.

Jaime Herrera: Colombia has always relied on government initiatives for transportation infrastructure, as well as on government regulation and subsidies for other sectors such as public utilities. In Colombia, Law 1508, 2012 encourages private initiatives (non-solicited offers) so that, in contrast with Brazil or Hong Kong, the private sector is the one undertaking and sponsoring infrastructure projects. Reliance on public spending could be dangerous: we are the perfect example of that. Colombia is far behind its peers in infrastructure development as a result of such reliance, along with a lack of regulation promoting private spending projects. When in the 1990s the energy sector was regulated in a way that promoted private participation, this sector boomed and today Colombia's energy sector is without doubt one of the healthiest on the continent.

Currently we are witnessing a resurgence of infrastructure projects, mainly in transportation. This is due to an aggressive public spending programme, together with legislative amendments fostering private spending projects as well.

***WWL:** Are there any recent legislative or policy changes in your jurisdiction which will have an impact on the financing for planned projects in the region? How would you assess the state of the current legal market of project finance specialists, and how would you describe the outlook for up-and-coming lawyers looking to break into the field in the next five years?*

Karen Wong: As discussed above, the expiration of tax benefits in the form of production tax credits and investment tax credits may have a chilling effect on the growth of the renewable energy industry which has become reliant on such federal benefits. On a more macro level, the implementation of Basel III, as well as the application of the Volcker rule, and other parts of the Dodd-Frank financial law will continue to impact banks' investments in the US.

That being said, there continues to be high growth in the project finance sector with many US and UK law firms looking to expand or initiate project finance practices in the US. The Houston market has been particularly active with the increased levels of activity in the midstream oil and gas sector and with the number of LNG, petrochemical, gas-to-liquids and methanol projects in development in the Gulf Coast states.

Filipe Lowndes Marques: Portugal was for a long time one of the most enthusiastic jurisdictions in the structuring of project financings – all types of projects were financed, from the normal bridges, energy plants and roads to the more exotic hospitals, prisons, courts and even the football stadiums for Euro 2004! With the financial crisis the availability of funding was much reduced, and this meant that banks used stricter criteria for approving deals, which in turn meant that the last few years have seen a significant reduction in the number of project finance deals. However, as mentioned in my previous answers, this period is hopefully behind us and slowly but surely project financing will regain its former usefulness to the relevant sectors of the Portuguese economy.

Robin Abraham: We feel that there's going to be plenty of work for project finance lawyers based in the Middle East over the next few years.

I've mentioned KA CARE in Saudi, but there's infrastructure development going on across different sectors throughout the region, and some of it is driven by legislative change. For example, there is cautious optimism in relation to the Kuwaiti project finance market following the successful closing of the Az-Zour North IWPP phase I project, which was the first project to be procured under a framework established by the Kuwaiti BOT law.

Elsewhere, Qatar is committed to upgrading its infrastructure ahead of the World Cup in 2022; major petrochemical sector projects have been announced in Oman; and there will be some large scale infrastructure projects in the UAE ahead of Expo 2020, being held in Dubai.

We're also seeing some new markets being serviced from lawyers based in the region, with an uptake in work in Iraq (particularly Kurdistan) and Africa. If you're looking ahead five years, depending on how the political situation evolves, Iran could be a very interesting market.

Jaime Herrera: The development of concession and private investment schemes into infrastructure was boosted through the enactment of Law 1508 of 2012 (public private partnership) and the new infrastructure law, Law 1682 of 2013. These two new laws (and encompassing regulations) have laid the bedrock for a more flexible, transparent, prioritised and dynamic legal regime for infrastructure projects. It is expected that these new laws will serve to encourage meaningful project finance transactions in Colombia in the not-so-distant future.

In addition, there are new regulations in the works that increase credit lines for the financing of the 4G road concession programme, and allow for certain infrastructure-dedicated compartments of up to 5 per cent of administered assets for private equity funds.

***WWL:** The preference of investors and developers has tended towards major, long-term projects such as government-backed infrastructure initiatives. How would you say this has affected the legal market and the work your firm has been doing? In terms of cross-border financing work, is it increasingly important to have international offices in key jurisdictions?*

Karen Wong: Milbank has had a long-standing philosophy of having offices in the key financial centres of the world. Because of our capability to advise on transactions governed by both English and New York law, we are able to handle all types of financing across the entire capital chain in the debt and capital markets. Rather than having multiple branch offices in various jurisdictions, we prefer to team with the best full-service firms in the countries and states where our clients have transactions, and to work collaboratively and efficiently with them to provide the necessary advice in cross-border transactions.

Filipe Lowndes Marques: During this period of limited deals in the Portuguese market we have been seeing strong growth in such deals in Angola and Mozambique, the largest countries in Portuguese-speaking Africa, both of which need considerable investment in infrastructure. Working with our associated offices, Angola Legal Circle and Mozambique Legal Circle, MLGTS has been able to bring to the table its extensive experience in the Portuguese infrastructure finance sector. Considering the similarity between the laws in the three jurisdictions, the solutions that have been found in the past for Portuguese deals are being fruitfully applied to the same issues in Angola and Mozambique.

Robin Abraham: While there are exceptions, the majority of large projects in the Middle East have had a strong government presence in some form, whether through: government-owned sponsors; government shareholdings being retained in project companies; or offtake arrangements. As such, we do not expect the legal market to change in any material way, so long as governments continue to look towards the private sector for financing.

There's no doubt that having a well-established presence in the Middle East has helped us win project financing work in the region. We have invested heavily in the Middle East since first opening an office in the UAE in 1975. Most recently we opened a full Clifford Chance office in Riyadh in January 2014. That said, a presence on the ground is certainly helpful, but the real key to capitalising on the presence is to have experienced lawyers and credible execution capability.

Jaime Herrera: The development of infrastructure mega projects is certainly propitious for the use of multidisciplinary, full -service law firms. The sheer number of legal issues that come about – from environmental, contractual and financial, to state contacting, financial and capital markets issues – make full-service law firms more suitable to adequately serve such complex matters. Having said that, although in Colombia we have seen our share of foreign law firms being opened, the legal market remains dominated by large national independent law firms.

Posse Herrera Ruiz was a pioneer in the early days of the 1990s, and remains a leading law firm advising in connection with project finance schemes for the development of infrastructure projects, including the energy sector and the transportation sector.

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