LATHAM & WATKINS LLP

CSP Projects: Ownership/Structure, Financing and Contracting Strategies

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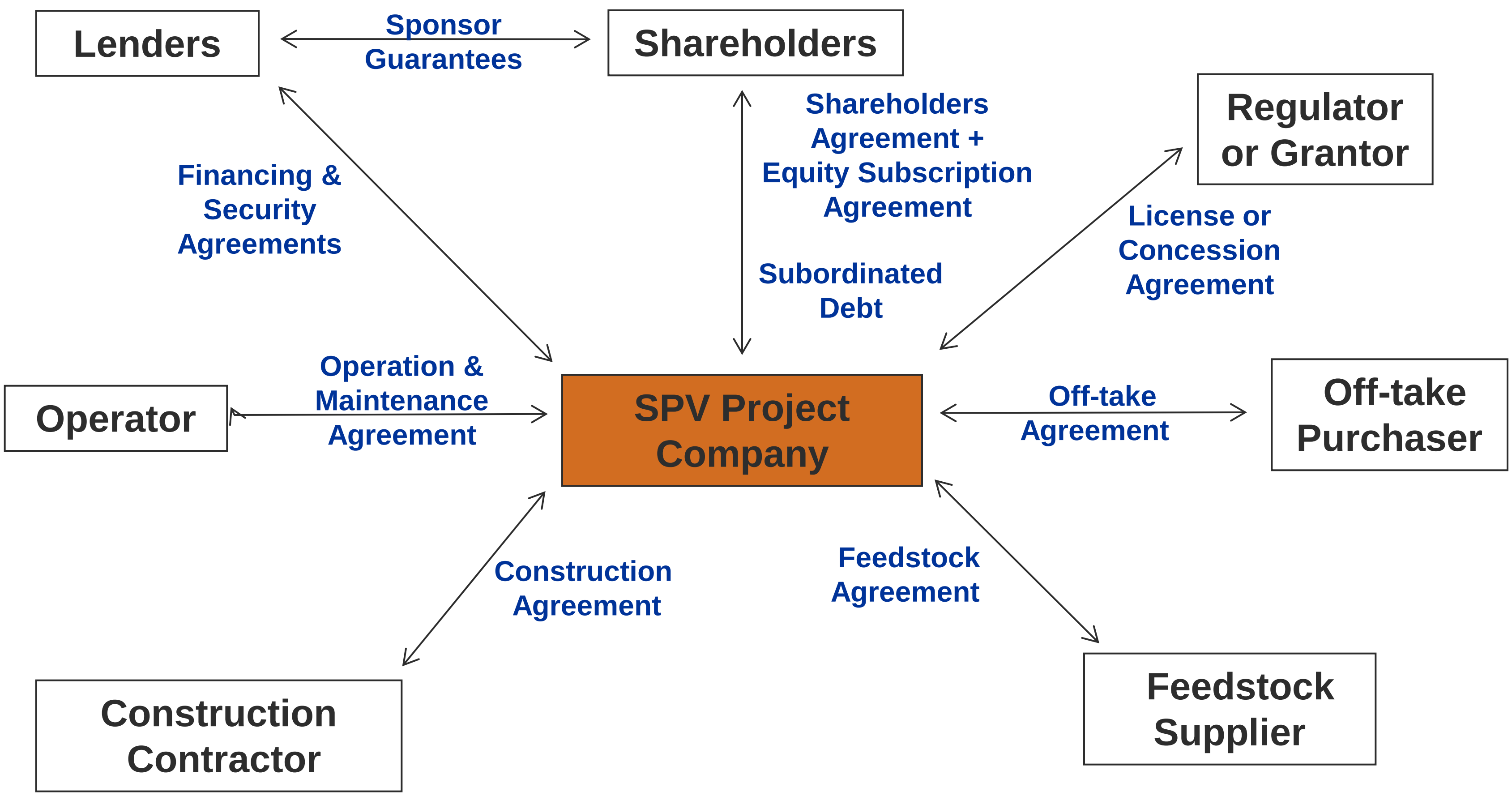
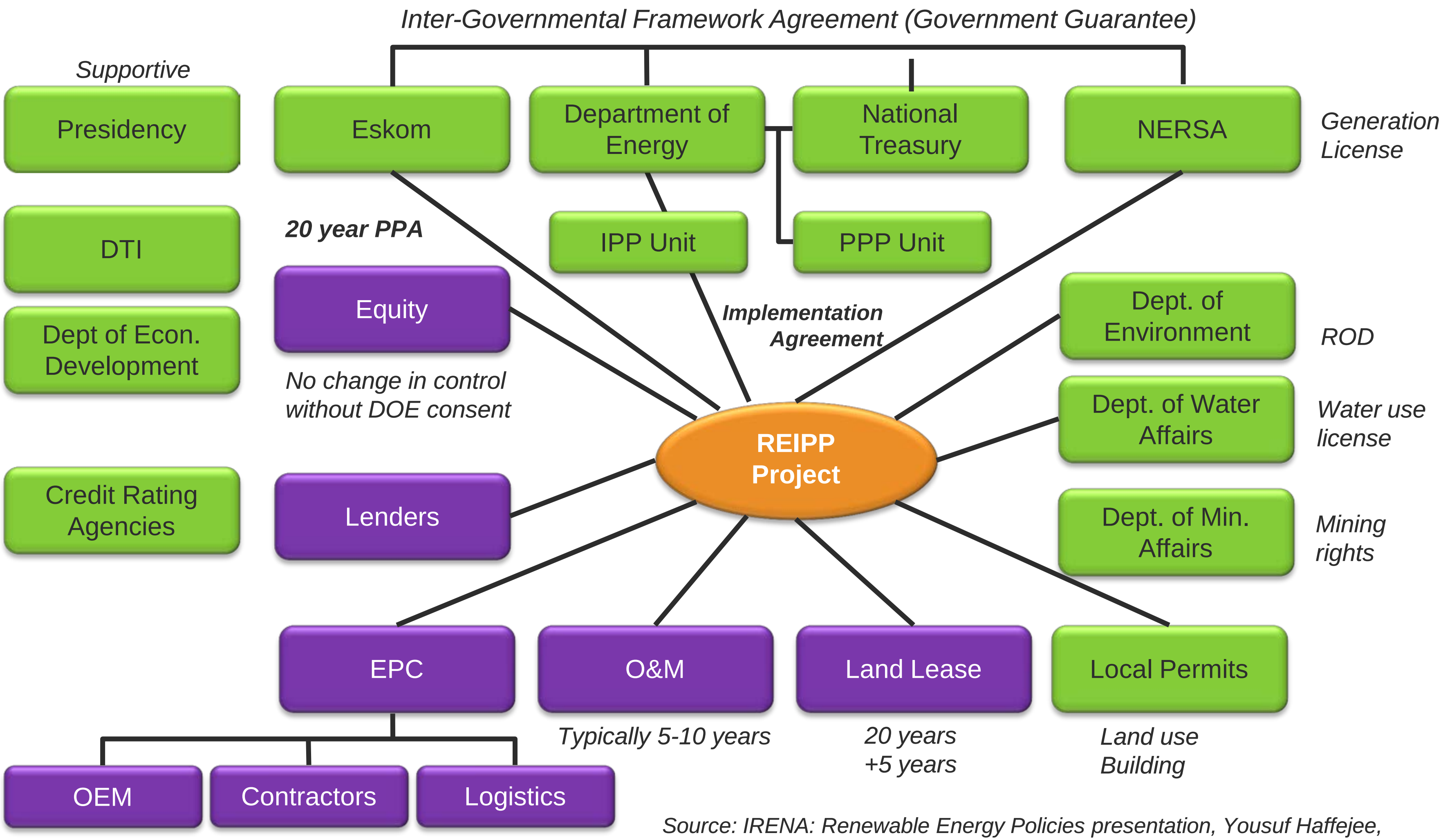
Typical PF Contractual Framework



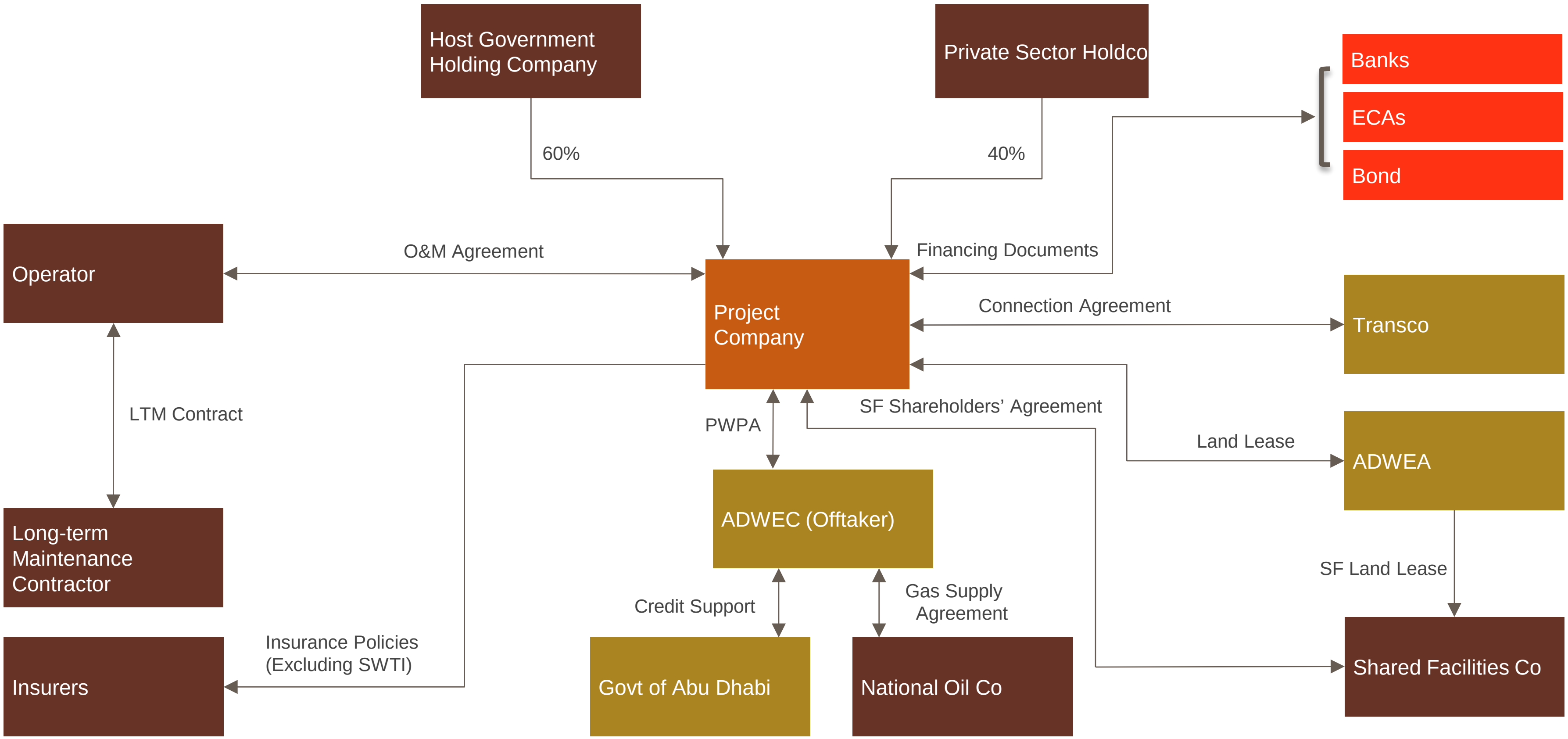
South African REIPP Projects – Typical Structure



Source: IRENA: Renewable Energy Policies presentation, Yousuf Haffejee, Head of Single Buyer Office, Eskom, January 2013

Typical Middle East “Hybrid” IPP Structure

Structure below is for the Shuweihat 2 IWPP in the UAE after the refinancing through a project bond



Issues for Key Participants

- **Project Company**
  - Limited shareholder liability
  - Restrictions on foreign shareholdings?
  - Tax structuring
    - Minimize withholding on revenue streams
  - Shareholder “exit strategies”
    - Vendor equity – early out the door
    - Minimum equity holdings

- **Sponsors**
  - Recourse – sponsors want limited/non-recourse
  - Shareholders in the Project Company
  - Other roles for Sponsor Affiliates, such as construction?
  - Equity funding subordinated to third party debt
  - Guarantee/completion undertaking/DSPU

Issues for Key Participants (cont.)

- **Commercial Lenders**
  - Relationship versus asset lending
  - Fees
  - Who is doing the work – monitoring, analyzing, cajoling and who has done their homework?
  - Lender liability (e.g. on enforcement)
  - How much control over “their” asset?
  - Intercreditor agreement with ECAs and other lenders (e.g., shareholders and hedging counterparties)
    - How many other banks required to vote for enforcement?
    - How much time must elapse before enforcement? Scoping provisions
    - Sharing of recoveries
    - Subordination provisions

Issues for Key Participants (cont.)

- **Export Credit Agencies (ECAs)**
  - Entities established to promote the sale of goods and services from suppliers in their respective countries
  - Environmental issues – the Equator Principles/World Bank Guidelines
  - Offer political/comprehensive cover
  - Distinct “personalities” and appetites for risk at each ECA
  - Policy “must-haves”
    - Environmental defaults
    - Individual enforcement action

Issues for Key Participants (cont.)

Commercial Lenders and ECAs

- Will want security over <u>all</u> Project Assets ('whole project security'):
  - bank accounts
  - share pledges
  - assignment of contract rights
  - mortgages
  - insurance assignments
- Will commonly also want 'quasi-security' – direct agreements and completion guarantees
- Intercreditor Agreement with ECAs and other lenders e.g. shareholders

Common Procurement Issues

- **Fully baked bid**. As part of the selection process, bidders are often required to submit detailed heads of terms of material contracts, including financing agreements and construction and operation contracts.

- **Second bites**. In some cases in the initial rounds of the REIPPP Programme, upon a bidder being selected as a preferred bidder, contractual counterparties would seek to re-negotiate issues previously agreed in the heads of terms, resulting in increased execution risk for all parties.

- **The devil and detail**. Delays in finalising full form documents could be avoided by ensuring that the heads of terms address all material issues (such as the scope of the insurance provisions in the EPC contract, which may require the appointment and participation of an insurance adviser at an early stage in the bid process) and ensuring that sensitive provisions, such as those relating to the credit quality of the contractor or the payment of liquidated damages, are settled at the outset.

Bankability, Contracting Strategy and Completion Support

- Contracting Strategy:
  - single LSTK contract? EPC vs EPCM?
  - multiple contract packages?
  - single point of responsibility: one EPC contractor or multiple contractors?
  - interface risks?

- Degree of technology risk

- Nature and extent of sponsor completion support:
  - full completion guarantee(s)
  - cost overrun commitment(s)
  - base equity / stand-by equity commitment(s)

Contracting Strategy

- Construction Contract(s)
  - Delay LDs
  - Performance LDs
  - Credit standing of contractor(s)
  - Nature and extent of EPC “outs”
  - Insurance
  - Construction Bond(s)

CSP Projects – Preparing for Success

- The term sheet structure needs to be confidently built on defensible economics, <u>not</u> reverse engineered
- Make clear the "non-starters"
- Develop an achievable schedule that recognizes other parties' constraints
- Take the time to "game out" term sheet and commercial structure negotiations and develop options
- Engage the first lender only when fully prepared
- Keep team resources constant, committed, and focused

Critical Issues & Deliverables

Initial Financial Model

1. Early Preparation of Financial Model

Advisors – Legal and Financial

1. Timing of Appointment / Initial Work Plan
2. Industry / In-country & Regional Expertise
3. Track Record
4. Fees & Expenses
5. Team Availability

Construction Completion

1. Weigh Completion Guarantee vs. LSTK Pricing & Availability / Finance Cost and Marketability of Arrangement
2. Develop Robust Completion Test Regime Early with Completed FEED Input
3. EPC Wrap – Creditworthy EPC Contractors
4. Delay LDs, Performance Bonds / Guarantees, Simple Technology

Prepare Term Sheet & Intercreditor Principles

1. Build in Flexibility, Game out Options & Negotiations before launch
2. Build the Term Sheet with the Model in View
3. Balance Innovation & Execution Expectations
4. Sponsor Support
5. Build in Refinance Structure & Incentives
6. Enforcement / Sharing
7. Commercial/ECA/DFI Financing Interaction
8. Prepare Security Package

Bankability

1. Identification and Allocation of Risks
2. Contractual Mitigation of Risks:
   a) Off-Take: Long-Term Contracts / Take-or-Pay Provisions / Strategic Industry Players
   b) Feedstock: Long-Term Supply Contracts /
   c) Land Lease: Long Unconditional Lease for Life of Project / Indemnities
   d) Environmental: International Standards / Equator Principles / World Bank
   e) Technology: Unconditional Grant of License & Information / Licensor Indemnity
   f) Direct Agreements / Assignment & Acknowledgments / Consents
   g) Lenders' Step-in & Cure Rights
   h) Insurance: On-Shore / Off-Shore, Re-Insurance, & cut-through Clauses

CSP Projects – Financing Considerations

- **Domestic Capacity**. The REIPPP Programme has benefited from the availability of funding from South Africa's deep domestic banking market, which is accustomed to the long tenors and other risks associated with project financing. However, given the tightening liquidity in the banking market and the volume of projects that will require finance, concerns have been raised regarding the need for additional funding sources.

- **Currency**. International financial institutions have typically struggled with the FX risk associated with lending to South African projects in USD or EUR but with repayments being made in ZAR.

- **DFIs and ECAs**. Development finance institutions have been key in financing CSP projects in the earlier phases of the REIPPP Programme. A bigger role going forward?

CSP Projects – Shams I

- Shams 1, located in Abu Dhabi, is one of the world's largest CSP solar plants and uses parabolic trough technology to concentrate solar irradiation to generate electricity.
- The transaction is widely regarded as setting a benchmark for renewable energy projects and the financing for such projects in the GCC region.
- The financing was provided by ten commercial banks (eight of which were international), which together provided approximately US$ 615,000,000 of bank debt to the project.
- Key challenges:
  - The project stalled as a result of an incorrect estimate of the direct normal irradiance at the project's location before achieving financial close in March 2011.
  - Abu Dhabi did not introduce a feed-in tariff, investment tax credit system or renewable portfolio standards which are typically used to facilitate renewable energy investment. This was ultimately addressed through a bespoke top-up "green payment".
  - Strong CSP pipeline building up regionally.

Why has the Middle East IWPP Model Remained Stable over 20 years?

1 Strategic Importance

- Power and water sectors are of critical importance to the host governments
- IWPPs are crucial for the continued supply of power and water to the host governments given continuous growth in demand

2 No Volume or Price Risk

- The Offtaker is obliged to purchase 100% of available power and water capacity for fixed payments, regardless of amounts dispatched
- Obligation is ultimately guaranteed by quality credits (e.g., the government of Abu Dhabi (Aa2 / AA / AA)

3 Robust Contractual Structure

- Robust and tested contractual framework that the banks are familiar with

4 Stable Long-Term Revenues

- 20+5 or 25-year term PWPA
- Capacity payments based on 100% of available power and water
- Variable output charge to cover variable and operating costs
- No fuel supply or price risks

5 Low Operational Risk

- Operator benefits from the procedures and expertise of the leading power developers in the world

6 Proven Technology

- Projects typically incorporate the latest proven version of turbines that are already used at a number of other major projects in the region

7 Strong Sponsorship

- Sponsor group typically includes some of the most successful developers, owners and operators of power and desalination plants worldwide

8 Alignment of Ownership

- Host government typically controls 50%- 60% of the Project Company
- Ownership stake aligns interests between owner, off-taker and host government as guarantor