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United States

PROJECT FINANCE

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This country-specific Q&A provides an overview of project finance laws and regulations applicable in United States.

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UNITED STATES
PROJECT FINANCE

1. What are the typical ownership structures for project companies in your jurisdiction? Does this vary based on the industry sector?

In the U.S., nearly every project company is structured as a special-purpose entity incorporated in the State of Delaware, in which all of the assets relevant to the project's development, construction and operations are owned and which entity's sole business is the development, construction and operation of the project. The SPE project company is in turn typically owned directly by an SPE holding company. This nearly universal project-level ownership structure is driven primarily by the expectations of financing parties.

The more interesting action is typically above the SPE holding company level, where ownership structures vary greatly by the nature and type of project, the industry sector, and the nature and type of investor capital. For example, in the renewable energy sector where tax equity investors have played an important financing role for well over a decade, intermediate holding companies are formed to bifurcate tax credit-driven investors from sponsor equity and pre-COD project company transfers to achieve stepped-up tax bases are common. Intermediate holding company ownership structures are also increasingly contemplating the growing role of sophisticated private equity capital on a portfolio-wide basis, where private equity investors are investing in sector-/regional-specific markets with equity and equity-like capital deployed for development activities and to fuel sponsor-led growth strategies.

In Latin America, the project-level SPE and immediate holding company SPE are also typical. Though, depending on the country and sector of the project, many project company ownership structures involve concession or concession-like arrangements with governmental and quasi-governmental entities, reflecting a significant difference in the qualitative nature of the project company's assets. This is particularly relevant to financing parties, and often times multilateral financing institutions and development banks play a role in bridging the risk gap reflected in private lending parties' generally lower valuation metrics.

2. Are there are any corporate governance laws or accounting practices that foreign investors in a project company should be aware of?

Most foreign investors investing in U.S.-based projects have an established track record in such activities and are familiar with Delaware corporate governance principals, U.S. GAAP and/or IFRS accounting practices, and the expectations and requirements of private financing parties. But the newly enacted Inflation Reduction Act (IRA) is genuinely new territory for foreign investors in the U.S., and new rules and regulations that are continuing to be developed through administrative guidance on tax credit "adders" for domestic content, energy communities and low-income communities are of particular focus.

3. If applicable, what forms of credit support from sponsors or host governments are typically provided?

Most project financings continue to fall somewhere on the recourse spectrum between non-recourse and limited-recourse to project sponsors and, where applicable, governmental authorities. Sponsors in traditional project financings continue to manage balance sheet risk by limiting recourse, though financing parties may receive limited support in the form of capped equity capital contribution commitments. Credit support remains a key requirement for pre-financing project development activities, including in particular posting of letters of credit, bank guarantees and surety bonds for construction activities, capacity auctions, interconnection obligations, and other counterparty arrangements; and governmental authorities continue to prefer credit support in the form of corporate guarantees from a credit-worthy sponsor entity. Additionally, we see

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limited credit support playing a roll increasingly in build-transfer transactions entered into among utilities and renewable energy developers, continuing to blur the lines in such deals between M&A and financing.

4. What types of security interests are available (and suitable) for a project financing in your jurisdiction?

Throughout U.S. jurisdictions, the standard suite of security interests granted by project sponsors to construction financing parties continues to encompass all assets of the project company owning all rights to the project's development, construction, ownership and operation, including all personal property (so-called "U.C.C. Article 9" collateral) and all real property rights of the project company relevant to the project. Additionally, construction financing parties typically receive a pledge of all ownership interests in the SPE project company. Financing parties additionally seek to bolster their security interests in Article 9 collateral comprising contract rights by entering into direct agreements with each major commercial counterparty to the project, whereby financing parties seek additional rights directly from such project counterparties under the key project contracts.

In the area of renewable energy, as tax equity investments have grown in the past decade, these project-level security interests have often been structured to fall away upon the project's completion (or placed in service date, in tax terms), whereupon a "back-leveraged" financing structure has operated to remove liens at the project company level and refinancing the outstanding project-level construction debt with proceeds of new debt issued to an intermediate holding company of the project (controlled by the project's sponsor) and with liens on all of the holding company's personal property as well as contractual rights to distributions from the project company for application to debt service.

Additionally, increasingly we are seeing more complex structures of security interests granted in the intermediate holding company levels of project developments, including "hybrid" collateral structures more familiar to private equity funds that include capital call rights against limited partner equity investment commitments. Such capital call rights are not traditional to project financing debt capital structures, but are increasingly being included in bespoke structures in which project sponsors are deploying private equity and other co-venturer capital.

In Latin America, traditional security interests packages remain the standard requirement of financing parties, including pledges of all project-level personal property and real property interests. There is little appetite in the Latin American region for non-traditional approaches, and typically any valuation gaps are expected to be covered through credit support, often in the form of a sponsor corporate guaranty.

5. How are the above security interests perfected?

In the U.S., the primary method of perfecting project-level security interests remains the centralized filing of UCC financing statements over "all assets" of the project, often filed with the Delaware secretary of state. This covers perfection over a majority of the usual Article 9 collateral. Common exceptions include the need to perfect by control over the project's bank accounts, typically pursuant to an account control agreement and often, in the case of projects, subject to the sole dominion and control of the financing parties. Another exception often applies to the pledged ownership interests in the project company when constituting limited liability company interests; rather than perfecting in these interests as "general intangibles" pursuant to the filing of a UCC financing statement and in order to better protect themselves against a potential future priority claim by a competing creditor (including a bona fide purchaser for value), financing parties often require such equity interests to expressly be both certificated and deemed to comprise securities under and for all purposes of Article 8 of the UCC so that the financing parties can perfect such security interests by possession of the physical certificates representing such ownership interests. Real property interests, whether ownership or leasehold, are perfected by the filing of a mortgage – and often accompanying fixture filings – in the appropriate state and local filing office. While not relevant to the perfection analysis, financing parties often view for practical purposes the contractual rights they seek to obtain from key project counterparties (tripartite direct agreements, in the case of contract rights; estoppels, in the case of real property rights) as essential counterparts to their perfected security interests.

In the Latin American region, there have been in recent decades significant developments in most countries to modernize their security interest recording systems, including adopting more centralized registries for perfection of security interests resembling the UCC filing process in all U.S. states. These more centralized registration processes have gained efficiencies and transparency for international financing parties. Local filing and registration regimes remain for real property

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interests. There remain more legal formalities associated with these registrations than generally applies in the U.S., such as notaries and stamp/documentary taxes.

6. Please identify how security is enforced (notably the enforcement options available for secured parties) both pre and post insolvency/bankruptcy of the project company?

The legal process for enforcing on project security is well established in the U.S. But rather, the practical and commercial considerations of the financing parties often renders the practice of enforcing on project security more fraught.

As a legal matter, distressed projects typically first enter into an out-of-court workout process, whereby the project's equity owners seek to restructure the project's debt load in a manner acceptable to the financing parties, often involving concessions on timelines, budgets, covenant compliance, and reserve account funding requirements. More often than not, this out-of-court workout is preceded by an extensive period of intermediary waiver requests from the project's owners.

When financing parties are not inclined to agree to a waiver request – usually in the case of an event of default resulting from a material problem that is not easily or readily cured by the project's sponsor – the first tool in their arsenal for potential exercise of remedies is delivery to the project and sponsor of a reservation of rights letter, whereby the financing parties memorialize the relevant event(s) of default and expressly reserve their rights to exercise any and all remedies available under the financing documents and applicable law. Such reservation of rights notice is not a formal legal requirement in order for financing parties to enforce on collateral, it is a practical tool utilized by financing parties while determining among the various financing parties (and potentially classes of financing parties) how they intend to proceed.

If financing parties determine to move ahead to foreclose on project collateral on an out-of-court basis, the UCC provides for several pathways, including consensual foreclosure and, less frequently, judicial foreclosure. Typically a financing party's first action when enforcing on project collateral is to block the project's access to its bank accounts, notify project counterparties under the various tripartite direct agreement and estoppel agreements that the project is in default and instructing such parties to deal directly and solely with the financing parties (or their agent), including directing any payments directly to an account of the financing parties. Article 9 of the UCC enables financing parties broad ability to foreclose on such collateral without requiring a court's involvement, as long as the various requirements of the UCC are strictly complied with, including notice and the broadly applicable principle of commercial reasonableness.

In practice, traditional financing parties' – financial institutions, multilaterals, and development banks collateral enforcement strategies go hand-in-glove with such parties' loan assignment rights under the financing documents. Because traditional financing parties are typically not in the business of owning, constructing and operating projects (and very well may have regulatory or corporate charter limitations on such ownership), foreclosing financing parties typically seek to identify a buyer of the secured debt obligations – often at a negotiated discount to the par value of the outstanding debt – and coordinate the foreclosure process with the purchaser of the debt, which purchaser may then avail themselves of the UCC rights to enforce on the project collateral.

In the event of a bankruptcy filing, enforcement on collateral is effectively stayed at the outset of the filing and ultimate resolution on project collateral is subject to a plan of reorganization approved by the bankruptcy court.

In Latin American jurisdictions, enforcing on project collateral is almost universally considered to be a more complicated process with less predictable outcomes, both legally and commercially. Whether due to labor protections, or governmental regulations applicable to (or state interests in) key project assets, enforcing on local project collateral usually requires availing themselves of local courts and the concomitant legal risk and delays. For these reasons, foreign financing parties seek to structure as much project collateral as possible in offshore vehicles as possible, including offshore bank accounts and intermediate holding company share pledges which are easier to enforce on quickly. Additionally, certain jurisdictions have developed local structures to facilitate foreign financing parties ability to enforce on project collateral without getting tied up in unpredictable and drawn-out court processes, including security trust vehicles and expedited enforcement on debt obligations evidenced by promissory notes.

7. What are other important considerations in relation to the security regime in the jurisdiction that secured parties should be aware of?

In the U.S., the overriding principle relating to the

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security regime relates to the parties' broad ability to contract directly as to their relative rights in an enforcement action, subject to the relatively light-touch approach of the UCC statutory regime applicable to personal property and to the involvement of courts upon a voluntary or involuntary bankruptcy/insolvency filing.

8. What key project risks should lenders be aware of in project financings in your jurisdiction? This may include, but may not be limited to, the following risks: force majeure, political risk, currency convertibility risk, regulating or permitting risk, construction/completion risk, supply or feed stock risk or legal and regulatory risk).

In the U.S., all of the traditional project risk considerations apply – legal/regulatory risk, technology risk, completion risk, force majeure, supply risk, etc. – though in different proportions depending on the nature of the project and project sponsor. In recent years, the concept of political risk has started to enter the considerations of financing parties due to increasingly endemic structural challenges to federal spending authorizations. Also particularly relevant in recent years has been supply risks due to supply chain inefficiencies and the flow-through effects on project construction timelines and of inflation on project budgets. And for renewable energy projects in the U.S., the growing regulatory and permitting risk posed by dramatically increasing interconnection delays in certain regions is rendering project development and construction timelines unfinanceable.

9. Has any public-private partnership models or laws been enacted in the jurisdiction, and if so, are they specific to certain industry sectors?

Many states in the U.S. have P3 laws and structures, nearly exclusively in the context of transportation and social infrastructure. Notwithstanding these laws and structures, there remains a relative dearth of such P3 transactions in a given year throughout the U.S., due largely to an ongoing public preference for public financing regimes (including municipal bonds) and the relative depth of private financing markets.

10. Will foreign judgments, arbitration awards and contractual agreements to arbitrate be upheld?

Yes, these are key components to the nearly universal perception of the U.S. as one of jurisdictions with low legal risk to projects and business generally.

11. Is submission to a foreign jurisdiction and waiver of immunity effective and enforceable?

Yes, see above.

12. Please identify what you consider to be (a) the key current issues for project financing in your jurisdiction; and (b) any emerging trends or topics which should be considered or focused on by project financing stakeholders.

Current key issues in the U.S. for project financing generally are the dual headwinds of rapidly rising interest rates and inflationary effects on project inputs and labor costs. This is broadly applicable to projects of all types and nature.

In the energy space specifically, these general headwinds have been joined by significant additional sources of friction, including increasingly untenable delays by grid interconnection authorities in certain regions and the increased mismatch between a project's costs and the contractually agreed purchase price for generated electricity in V/PPAs. These headwinds have been operating to constrain what would otherwise be extraordinary momentum in the renewables sector due to massive recent governmental investments by subsidy pursuant to the recently passed Inflation Reduction Act (and, to a somewhat lesser extent, the Infrastructure Investment and Jobs Act and the CHIPS and Science Act) and record in-bound private capital investment interest into the U.S. renewables and energy transition sectors.

Additionally, the price of natural gas and generally ongoing expectations of investment in combined cycle facilities, we continue to see activity in both the midstream sector and repowering of combined cycle facilities.

Particularly relevant to the energy transition economy is the role the IRA has already played to meaningfully accelerate the advancement of projects in clean technology areas that to date have had limited (if any) private financeability. Battery storage projects went from being the frontier of project finance 18-24 months ago to a staple of the solar/renewables project financing

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market. Deployment of clean hydrogen (green and blue) alongside industrial commercialized products, and carbon capture technologies, are gaining financeability through monetization of newly generous tax credits under the IRA, coupled with the important new feature of transferability of such credits.

13. Please identify in your jurisdiction what key legislation or regulations have been implemented (or will / plan to be) for projects in connection with the energy transition?

See above.

14. Please identify if there are any material tax considerations which need to be taken into account for a project financing in your jurisdiction, and if so, how such tax issues can be mitigated.

As described in more detail above, tax subsidies have long been staples of renewable energy project financing. Historically, the tax credit regime in the U.S. operated functionally as a high hurdle for foreign investor capital, due to the legal complexity of the tax-inflected financing regime and its particularity to the U.S. When combined with the relatively high U.S. legal costs and general bespoke nature of each project's contractual arrangements, foreign investors had long been reluctant to dedicate the resources and capital to such projects. The passing of the IRA in 2022 caused a near 180 degree change of direction by foreign investors, not due to the IRA's elimination of legal complexity and expense (if anything, the net effect is more complexity and higher legal spend) but because of the historically generous subsidies making many new projects "pencil out" profitably. Since then, many foreign governments in Europe have been actively pursuing their own iterations of the IRA, not only to continue developing their clean energy sectors but to also maintain some of the private capital that is otherwise now flowing to U.S. projects.

15. What types of funding structures (e.g. debt, equity or alternative financing) are typical for project financing in your jurisdiction. For example, are project bond issuances, Islamic finance and – in the context of mining deals – streams or royalties, seen as attractive (and common) options for stakeholders?

As described above, in the U.S. the "capital stack" for projects is often times deep and layered. Depending on market sector, this capital stack will include federal grants/loans (DOE, DOT), local and state grants and subsidies, development/FEED-stage debt from shareholders or investors, a growing class of private alternative lenders to energy project developments, traditional financial institutions for construction debt, tax credit-driven investment capital, growing private equity fund capital ranging from equity to mezzanine debt to senior secured debt (in the case of credit funds), and increasingly private equity capital funding development-level capital requirements of project portfolios to generate scale.

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