INTRODUCTION
The unprecedented economic growth in Asia has created an enormous demand for financing solutions for economic and social infrastructure projects in the region. The development of infrastructure projects with private capital has become a commonly adopted strategy for procurement in Asia.

While the private sector, in project financing, can be involved in the development of infrastructure on an independent and standalone basis, this paper will focus on private participation through Public Private Partnership (PPP) arrangements. These are arrangements whereby the public sector awards a long-term contract for the delivery of a service, requiring an initial capital investment by the private sector through the construction of a facility or the enhancement of an existing facility, such as a port, road, rail system, sports stadium or hospital. The private sector partner finances that capital investment, carries out the construction or enhancement and uses the facility to provide the service; it usually (but not always) transfers control of the facility to the public sector at the end of the contract. The public sector may pay the private sector partner a regular availability payment by reference to the standards to which the service is performed or grant the private sector partner the right to collect the income associated with the facility (eg tolls, farebox revenue or other user charges) or both.

Whilst variations of this broad model are known by a number of names (eg concession, Build Operate Transfer (BOT), Build Own Operate Transfer (BOOT), Design Build Finance Maintain (DBFM), Design Build Finance Maintain and Operate (DBFMO)), we will refer to the broad model in this paper as the PPP model.

The PPP model has been widely embraced. Newly industrialised countries with tremendous infrastructure demands such as China and the developing countries of Vietnam and Indonesia, as well as industrialised countries with established PPP frameworks and policies such as Australia and Korea, have adopted the model. In order to sustain Asia’s extraordinary economic growth and cater to the region’s massive financing needs, PPPs offer viable public service delivery alternatives in light of limited government budgetary resources and introduce private sector efficiency and innovation.

As a result, a significant amount of new capacity will continue to come from private participation using project financing techniques adapted to the particular markets in which the projects will be built and operated. This point has not been lost on the vast number of developers, construction contractors, facilities managers and operators, equipment producers and their professional advisers who are based in the region.

PPP: OVERVIEW
Under a PPP structure, a government typically grants a concession to a project company under which the project company has the right to build (or enhance) and operate a facility, for instance, an oil refinery, power station, water treatment plant or transport infrastructure - an area that would previously have seen direct funding. The project company (the employer under the construction contract) raises equity and borrows from lending institutions or the debt capital markets in order to finance the construction or enhancement of the facility. The loans are repaid from the income associated with the operation of the asset during the life of the concession. This may take the form of user charges or payments from government under the...
concession or offtake agreement (or a combination of both). At the end of the concession period the facility is usually transferred back to the government, hopefully after the project company has obtained a return for its equity investors. This type of structure is popular with governments in the region as it enables them to develop infrastructure projects without committing their limited resources upfront to particular projects.

Strictly speaking, a PPP structure is, in itself, a structure that involves non-recourse or limited recourse financing. That is, financing where lenders are repaid solely from the cash flow generated by the project and whose only security is in that revenue and the assets of the project. However, pure non-recourse or limited recourse financing can be difficult to obtain in this region as lenders are seldom willing to commit the large amounts needed for today's international projects solely on the basis of a project's expected cash flow or assets.

Accordingly, most international project financings (especially in the emerging markets of Asia) tend to be financed on a basis that minimises the lender's risks by incorporating a number of back-up or secondary means of credit support provided by the host government, sponsors, purchasers or other counterparties, while also relying primarily on the project company's cash flow to service the debt and security provided over the assets of the project company. However, credit support by sponsors can effectively operate to defeat the limited recourse nature of the project financing (see credit agreements and sponsor participation in the sections below). For that reason, it is important to pay special attention to the allocation of risk when using sponsor support to create a bankable project.

THE CONTRACTUAL FRAMEWORK

A PPP is a relatively complex structure with a large number of elements that need to be combined and integrated. It requires an extensive network of inter-related and often inter-conditional contracts, as outlined in the simplified structure shown in Diagram 1.

Diagram 1: Typical PPP project structure: principal parties and various contracts

A PPP will usually include all or at least a majority of the following agreements.

Concession agreement

A concession agreement, licence or mineral lease between the government authority and the project company is the cornerstone of the structure as it effectively gives the project company the right to carry out the project. Concession agreements and the extent to which they address specific sponsor protections will vary significantly in Asia. Very few countries in Asia have laws specifically dealing with PPP projects as a group. In some cases, the right to carry out the project is sourced in special legislation enacted by the relevant government. For example, in Hong Kong, infrastructural facilities such as the Cross-Harbour Tunnel, Western Harbour Crossing and Tate’s Cairn Tunnel are governed by individually enacted ordinances, where each particular project scheme must first be approved by the legislative council.

In other countries the concession agreement will be a very loosely drafted document where parties will rely more on the goodwill of the host government (and its need to develop projects in the future) than on the contractual
terms of the concession agreement. As a consequence, sponsors and lenders are often faced with concession documentation that is not as comprehensive as they might like.

The position taken by sponsors and/or lenders in this situation varies. Nevertheless, even where the sponsors and/or lenders are of the view that a concession agreement requires amendment, they should bear in mind that there are often sensitive political matters that need to be considered when requesting changes. Hence, it is not unusual for lenders and/or project sponsors in this region to find themselves in a position where they must determine whether what they perceive as a deficiency in the concession agreement is, or can be, dealt with in a way other than through amendment of the document. For example, should the deficiency simply be considered as another manifestation of any political risk associated with the project?

Many countries are aware of the considerable drawbacks that arise from such practice and legislative initiatives have been introduced to address these inadequacies. For example, China, a country that traditionally regulates projects on a case-by-case basis though contracts, has enacted legislation regulating infrastructure concessions such as The Urban Infrastructure Concession Regulation of Beijing Municipality, 1 March 2006.

Offtake agreement

Revenue risk can be managed through an offtake agreement between the government authority and the project company by providing the project company with a sufficient pre-determined revenue stream to ensure payment of its project obligations, operating costs and a return for its sponsors. An offtake agreement will typically take the form of a "take-or-pay" agreement, which provides that the offtaker has the option of either taking the project's product or paying for the product (even if it is not taken) at the agreed tariff. Long-term agreements such as these would normally be entered into for gas or electricity generation projects, since sales would not be made on a spot or retail market.

Although the structure of these agreements does not generally cause a problem under English law, with the exception of poorly drafted take-or-pay provisions that may constitute a penalty, this is not always the case in countries in this region. In a number of jurisdictions in the region, particularly those which do not have an English law background, the adequacy of consideration in a contract is of great importance. For example, while an English court will generally not be interested if a utility ends up paying 10 times the market price for gas because of its take-or-pay obligations, this can be of great importance elsewhere. Therefore, proper advice should be taken regarding proposed offtake agreements, not only in relation to their enforceability but also in relation to their structure. Another consideration that may arise in some of the more regulated economies in the region is whether an adequate offtake agreement can be negotiated. For example, if electricity prices are subject to central controls, it may not be possible to simply "pass through" costs to the offtaker (as is the case in China).

Construction contract

A construction contract between the project company and the construction company will typically be in the form of a comprehensive turnkey contract, which should ensure that the contractor will deliver a completed and operational facility. The turnkey model provides for the project, capable of meeting its projected operating standards and contractual obligations, to be handed over and be ready for immediate operation. For that reason, it is not unusual for sponsors to try and shift all completion-related risks onto the contractor.

Nevertheless, participants in projects in this region should be prepared to consider variants to familiar contractual structures. For example, it is possible in Thailand and Indonesia for a project company to avail itself of certain tax savings if the construction contracts are structured so that there is a clear division between work that is carried out onshore and that which is carried out offshore. Furthermore, licensing restrictions in Vietnam may also necessitate splitting the turnkey contract. Accordingly, some participants in such a project will need to review any conceptions they might have as to how the construction documentation should be structured.

Supply agreements

A fuel supply agreement between the project company and the fuel supplier varies in sensitivity depending on the fuel used by a project and the source and ownership of the fuel. Security of supply and price certainty is of key importance for the project. It is also important that fuel pricing and adjustments of terms are capable of being passed through under the offtake agreement in order to protect the project’s revenue projections and debt servicing capacity. The development of complex and innovative fuel supply and storage strategies may be needed if long-term fuel supply agreements are not available. This would not be necessary where the project provides its own raw materials or the project itself is the actual extraction of natural resources.

There may also be an equipment supply agreement(s) with a supplier(s).

Operating and maintenance agreement

An operating and maintenance agreement between the project company and the operator allocates facility
operational risks and aims to ensure that the operator meets performance guarantees tied to maximising revenues under the project’s offtake agreement or achieving minimum standards under the concession agreement. Special attention should be paid to managing the costs of operating the facility, interface and handover transition from the construction contractor, scheduled and unscheduled maintenance and ensuring that the project revenues are protected by establishing appropriate cost cover and/or pass-through mechanisms in the offtake agreement.

If, however, the project company is able to operate and maintain the facility itself, then an operating and maintenance agreement would not be necessary.

Credit agreement

A credit agreement is the principal legal document between the banks and the project company that details the express terms on which the banks will advance funds to the project company together with any associated security documents. Some of the issues parties will need to consider are: the currency of the loans (should they be denominated in the principal currency of expenditure or the currency of the projected revenues?); the manageability of the drawdown and reporting requirements from the project company’s point of view; and whether any control amount requirements reflect local legal requirements. For example, any instance of a rigid onshore account/offshore account structure will not be appropriate if exchange control consent is required for each transfer of foreign currency offshore.

In certain cases, for example where an engineering, procurement and construction contract wrap cannot be obtained, it may be necessary to provide sponsor support to strengthen the capacity of the project company to satisfy its obligations to the banks and to have a “bankable” project. Forms of sponsor support may include equity subscription agreements (base and standby equity), completion guarantees of whole or part of the debt until the project commences commercial operation, bank guarantees to support completion guarantee, and cost overrun guarantees/facility. Sponsor guarantees can be made to cover the bank debt or completion guarantees - for example, by ensuring that the lenders will be paid back a set amount if the facility does not reach completion or the repayment of scheduled debt service, of principal plus interest, if completion is delayed. Other forms of support may be incorporated where the sponsor is a party to a key project contract (such as a construction contract, operating and maintenance agreement, or offtake agreement by requiring the sponsor to provide additional guarantee letters of credit or corporate support to underpin the project). Sponsor support is also addressed in relation to sponsor participation (see discussion below).

Shareholders’ agreement

A shareholders’ agreement sets out the respective rights and obligations of the sponsors with respect to each other and the project company. In project financing, special attention should be paid to the handling of potential conflicts of interests. This is especially the case where both private sector sponsors and the host government are equity holders. Depending on the jurisdiction, the applicable laws surrounding the negotiation and drafting of shareholder agreement provisions may require certain issues to be resolved in other documents, such as the project company’s constitutional documents.

Direct agreement

Direct agreements are typically between the banks and key contract counterparties, such as the construction company, operator and offtaker, and are required to protect the economic interests of the banks. Circumstances may arise where the project company is unable to meet its liabilities and the banks will seek to enforce their security interests and therefore look to direct agreements to give them the ability to keep the key contracts on foot, despite the insolvency of the project. Direct agreements have become customary practice in project finance since non-recourse financing limits the security of the banks to the core assets of the project company, such as project fixtures, property and the revenues of the project company. The granting of security over the project company’s assets for its borrowings can be quite complex if third parties become involved in the security arrangements. The involvement of third parties may be necessary if security is being created over contractual rights, which is typically the case.

Direct agreements should not improve or worsen the situation for any of the parties and project contracts should be structured so that the interests of the lenders can be protected without adversely affecting the ability of the project company and the counterparties in exercising their respective rights and obligations under the various contracts. Step-in rights, whether structured on a permanent or temporary basis, are a key benefit to a direct agreement. This is because, if the project finds itself in trouble, it allows for banks to place themselves (“step in”) to the position of the project company under the contracts over which they have security on pre-determined terms. Certain jurisdictions may not allow direct agreements to be entered into and step-in rights may need to be structured in a different form.

It is of vital importance that these agreements are properly structured to ensure the bankability of the project.
RISK IDENTIFICATION

There are a variety of potential project risks, some more easily identifiable than others. It cannot be expected that all risks will be mitigated or contracted away. However, proper identification, assessment, allocation and management of risk can create a commercially viable and bankable project, and play an important role in assessing the need for back-up of secondary credit support (discussed above). PPPs are generally structured on a basis that requires all parties to share the risks of the project. Project risk-sharing is necessary because the project company will usually have limited equity, which is substantially less than the aggregate net worth of the sponsors.

Factors such as the type and scale of a project, the country where the project is located and the type of PPP implemented create a unique set of risks for each project. Risk identification is the first step to managing them appropriately and parties generally identify project-level risks by breaking them down in three stages:

1. Development/financing
2. Construction
3. Operation.

Within each of these stages multiple sources of risk exist. Table 1 categorises each stage and outlines general non-project/region specific sources of risk to consider.

Table 1: List of Potential Risks: Non-Project/Region Specific

<table>
<thead>
<tr>
<th>Development/Financing</th>
<th>Construction</th>
<th>Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adverse economic climate in host country</td>
<td>Land acquisition</td>
<td>Cost overrun</td>
</tr>
<tr>
<td>Lack of creditworthiness</td>
<td>Construction cost overrun</td>
<td>Operator’s incompetence</td>
</tr>
<tr>
<td>Bankruptcy risks</td>
<td>Construction time delay</td>
<td>Performance risk</td>
</tr>
<tr>
<td>Financing risks</td>
<td>Material labour availability</td>
<td>Low operating productivity</td>
</tr>
<tr>
<td>Complex financial structures</td>
<td>Project site conditions</td>
<td>Availability of material</td>
</tr>
<tr>
<td>Lack of guarantees loans</td>
<td>Contractor’s failure</td>
<td>Force majeure events</td>
</tr>
<tr>
<td>Variation in budget est.</td>
<td>Force majeure events</td>
<td>Regulatory risk</td>
</tr>
<tr>
<td>Force majeure events</td>
<td>Force majeure events</td>
<td>Political risk</td>
</tr>
</tbody>
</table>

The highest degree of risk exists during the construction phase of a project, as funds have been advanced and the revenue stream on which the lenders and investors are relying upon for repayment has not yet commenced.

Once the project's risks are identified, the likelihood of their occurrence assessed and their impact on the project determined, the risks and obligations should then be allocated to the parties with the best financial and technical capabilities to manage them, thereby spreading the risk and responsibilities to create a bankable project. Therefore, the primary consideration at the outset in analysing risk sharing is that the risk must be placed with a party to the PPP structure, which is willing and able to accept and manage that risk.

RISK ALLOCATION

At its most basic allocation, risk in a PPP will be apportioned as follows: market risk will be borne by the sponsors; detailed design, construction and commissioning risk will, to a large extent, be taken by the construction company; operating risk will be taken by the operator; and all residual risks, including those risks arising as a result of the mismatching of risks among participants (including insurers) will be taken by the project company. Many of the project risks identified in the previous section are allocated to stakeholders in the project through the project documents such as those discussed above in "The Contractual Framework".

However, the government and the lenders may also bear a significant proportion of these risks, albeit indirectly. For example, if the project company is responsible for providing fuel and the fuel is below the specified quality, a power station might not be able to perform to the required specification. To alleviate this problem, the project company must back-to-back its obligations to the construction company under the construction contract with its entitlements under the offtake agreement with the government. The risk would, therefore, ultimately end up in the hands of the government and/or the lenders, which is not a position they set out to achieve.

The allocation of risks in this way helps to mitigate the risk where possible, by either reducing the likelihood of risk occurrence or the impact of the consequence, if the risk were to occur. Transferring the risks to the party who is in a better position to manage and control the risk at a lower premium or cost is a beneficial mitigation technique. The selection of experienced, qualified and financially strong parties with proven track records in developing similar projects can enhance protection against performance risks. Other mitigation tools include insurance for events such as force majeure or business interruption and the employment of hedging instruments to mitigate macroeconomic risks such as interest rate, inflation and foreign exchange risk.

The participating parties may include:

Government/government authority

Infrastructure projects in this region will normally involve the local government, either acting through its ministries or an appropriate government authority. It is normally the pivotal player. It will initiate the project, conduct the tendering process and evaluation of tenders and will grant the project company the concession. The local government also either grants a long term lease of, or sells the site for, the project to the project company and will often acquire most or all of the service provided by the facility. Typically, the government will try to limit its liability and seek to retain a level of control over the
project, while limiting its undertakings and retaining flexibility.

A critical issue to consider here is whether the government authority has the appropriate statutory power to enter into each of the project documents to which it is a party and perform its obligations thereunder. If the authority does not have the requisite powers, its actions will be ultra vires, and therefore void. To determine whether a government authority's actions are intra vires or ultra vires, it is necessary to examine the legislation under which the authority is constituted. If the legislation does not give the authority the power to enter into and carry out the project, the legislation will need to be amended by the government so that the project can be carried out. Furthermore, many of the projects proposed in this region, for example in China, involve government authorities committing assets, such as land, to the project company as opposed to subscribing for shares. Care must be taken, especially in controlled economies, to ensure that the authority involved actually has title to the assets being transferred to the project company. If not, the appropriate government agencies will have to be approached.

Also, in the case of PPPs, government utilities and entities are often the off-takers of the project’s product (such as power). As such, under the terms of the off-take agreements governing such purchasing, a government entity may guarantee payment in respect of certain levels of product output. For example, in countries such as Korea, risk sharing strategies have been adopted for PPP, such as the Minimum Revenue Guarantee (MRG Scheme), as a way for the government to guarantee payment to private investors if revenues fell below a certain level or performance. However, the MRG Scheme was abolished in 2009 due to criticism over unreasonably high returns to private investors and its being morally counterproductive with regard to incentivising private operators to generate revenues. It has since been replaced with a similar risk sharing strategy.

**Project company**

The project company will usually be a company, partnership, limited partnership, joint venture, or a combination of these. This will be influenced by the legal and regulatory framework of the host government. For example, foreign participation in large-scale projects in China is usually through a joint venture arrangement with the government or the state-owned enterprise responsible for the development of the particular industry. The tax regimes and foreign exchange rules may also affect the ownership structure.

As mentioned previously, many PPP projects are structured deliberately to insulate the project company from as many risks as possible and ring fence the liability of the sponsors. In these cases, the project company is intended to be a mere financing vehicle and risks will be passed through it.

**Sponsors and shareholders**

The project sponsors are those companies, agencies or individuals who promote the project and bring together the various parties and consents necessary to get it under way. They are usually involved in some aspect of the work, for example the construction, operation, purchase of services or ownership of the land. They are invariably investors in the equity of the project company and may be debt providers or guarantors of aspects of the project company's performance. Since infrastructure projects typically consist of risks that are beyond what project sponsors may be willing or are able to provide or assume themselves, project financing can be appealing to sponsors for several reasons. In addition to providing for the allocation of project risks among multiple participants, a project finance structure takes the form of financing that is legally non-recourse to the sponsor, it can achieve "off balance sheet" accounting treatment of project debt, and it allows for highly leveraged structures.

The support provided by project sponsors varies from project to project and includes the giving of comfort letters (which is not particularly common in projects in this region), cash injection undertakings (both pre- and post-completion), as well as the provision of completion support through letters of credit. For example, completion or cost overrun guarantees may be a requirement of the lender as a condition to providing debt (see credit agreements discussed above “The Contractual Framework”).

**Private sector lenders and banks**

Factors such as the political, economic and social importance of the project development, the location and the commercial risks will have an impact on the types of project lenders. In addition to the possibility of public sector lenders such as multilateral and Export Credit Agency (ECA) involvement, which will be discussed below, due to the sheer scale of the project the financing for a PPP will usually involve a syndicate of banks and, from within that syndicate, an arranging bank or banks, which will take the lead role in negotiating the project and finance documents. It must be kept in mind that lenders may face the full risk of loss if the project fails as they have no recourse (on a non-recourse project financing basis) other than to the assets of the project. Their appetite for risk should be adjusted accordingly. The syndicate will most likely include banks from the host country, particularly if there are restrictions on foreign banks taking security over project assets. Involvement of local banks can offer risk mitigation by providing local
knowledge of the regulatory system and political environment and local currency financing to provide a natural hedge to currency exposure in the project.

The syndicate will necessarily undertake a review of all core project documents to assess the allocation of risks and how that allocation impacts upon their credit approval and the need for additional credit support. These will often be evaluated in conjunction with an experienced engineering firm, which will assess the design of the project and the technical aspects of the contracts. It is imperative that the promoters of the project and their consultants and advisors understand that this review of the documentation is an essential part of the credit process for nearly all lending institutions and that the comments and requirements of the lending institutions will not be dealt with by insisting that the documentation reflects the agreement reached by the various non-lending parties and, therefore, cannot be changed. It is also important that the promoters of the project and their consultants and advisors appreciate that the requirements of the lenders and their appetite for risk is different from sponsors of projects funded "on balance sheet", where those sponsors have a successful track record of delivering similar projects and are willing to put their balance sheet at risk for a return on equity. In fact, the most prudent approach would seem to be that the project implementation structure, contractual framework and contract documentation should be developed in consultation with the lending institutions, if at all possible, particularly as issues such as their assignability, payment mechanisms and the underlying rights of termination will be of importance to the lenders.

One of the principal concerns the lenders will have, apart from satisfying themselves as to the general apportionment of risk, will be to ensure that they can take effective security over all or the principal assets of the project.

Public sector lenders: multilaterals and ECAs

Multilaterals and ECAs are, fundamentally, government-backed suppliers of financing and other credit support that possess a variety of tools that are typically unavailable to commercial entities on their own. Such institutions are founded on the basis of policy established at an intergovernmental level rather than commerce. The use of these organisations to provide financing or political risk insurance can be seen throughout the region. Numerous projects in the emerging markets of Asia are co-financed by multilaterals such as the World Bank or its private sector lending arm, the International Finance Corporation, or by regional development agencies, such as the Asian Development Bank. For example, the International Finance Corporation multilaterals or similar regional or national development banks may be instrumental to a sponsor in completing a financing if political risks are significant, or if export content may be insufficient to obtain financing from ECAs. ECAs also play a very important role in the financing of infrastructure projects in the region. However, unlike multilaterals, ECAs seek to provide direct support for the national interests of their home countries.

Given the state of current commercial bank liquidity in the region, it is certainly worth considering structuring the project to engage one or more ECAs. The involvement of these agencies may affect the transaction as they have their own policies and requirements. However, our most recent experience in this region has been that a number of these agencies are becoming more flexible in their approach to the way projects such as these are documented. In particular, a number of the agencies have begun to recognise that there is a need for some form of inter-creditor agreement between themselves and other commercial lenders when the agency is participating in financing as just one of a number of groups of lenders. The participation of these agencies in project financing offers many benefits such as the alleviation of some of the concerns about the inherent political risks in the host country, they may offer a longer repayment period for emerging market economies than those that are available in the current commercial bank market and they are typically exempt from withholding tax.

Construction company

Often the conceptual design of the infrastructure is dictated by the experienced utility. Nevertheless, the construction company will usually assume responsibility for designing the facility and taking it through all stages of construction until it is mechanically complete. Further, depending upon the nature of the infrastructure, the commissioning and output performance risk (that is, the risk that the technology will work and that the infrastructure will operate to predetermined performance standards) is often allocated to the construction company.

The project company will aim to require the construction company to enter into a fixed-price, fixed-time, turnkey construction contract. This is rarely fully achieved, as there are normally some cost, event or timing risks that are not taken by the construction company, which can lead to variations in price or time. Generally speaking, the construction company will only assume risk that has been adequately compensated for or that which can be passed through to subcontractors.

Operator

The complexity of operating and maintaining facilities often require significant skills or resources that are unavailable to the project company, this results in the need for private operators. There has not been a shortage of
private operators for proposed infrastructure projects. This probably has a lot to do with the fact that operators tend to accept little risk in the form of up-front capital or expenditure. A private operator simply anticipates making a profit from operating the infrastructure more efficiently than an equivalent government operator. However, robust operating warranties and commitments, as required by lenders to mitigate technology risks, could hinder the operator’s anticipated profits if adequate compensation for assuming such risk is not provided.

The other parties usually involved in an infrastructure project include equity providers, insurers, equipment suppliers, fuel suppliers and, of course, various consultants. Most of these parties will also involve their lawyers and financial and tax advisers. The presence of a multitude of parties and their differing interests will, therefore, lead to an increase in the complexity of the project.

**RISK ANALYSIS: ASIAN MARKET**

To give a definitive list of risks that will form part of the risk evaluation process is beyond the scope of this paper. Each particular country has its own inherent risks. Some of those that have particular relevance in the emerging markets of Asia include:

**Country and political**

Most developing countries in Asia have, in the past, lacked clearly defined policies for the role of private infrastructure projects, particularly in politically sensitive fields like energy generation. However, as a matter of necessity, there is evidence of a general move in these countries towards establishing appropriate structures for investment in privately financed infrastructure projects.

Nevertheless, it is usually not enough to establish the mechanism for private investment without also establishing a regime that provides indirect support. The necessary requirements to convince the parties, and indeed the banks, of the long-term viability of these projects include a legal and regulatory framework that addresses issues such as land, utilities, tax, import controls, conversion and repatriation of profits, commercially based tariffs that permit a reasonable return on investment and other support measures. Without these the project may have to be financed with direct government guarantees. As PPP regulation and legal frameworks are now being rapidly implemented in less-developed countries throughout this region, investment incentives such as preferential tax incentives, exemption of land rental, foreign exchange guarantees and performance guarantees to ensure the bankability of projects are being offered. However, such incentives are usually applied on a discretionary and individual basis.

Structuring privately financed infrastructure projects without a clear regulatory regime can lead to long and complex negotiations to get to the stage where there is a "bankable" proposition in terms of the project documents. For example, in Vietnam, land acquisition can be extremely time-consuming since land is still considered a state subject, notwithstanding recent land law amendments attempting to rectify this issue. Indonesia, recognising the importance of land acquisition to the PPP scheme, passed a regulation providing the legal basis for the Indonesian Government to acquire infrastructure project land from the land owners by providing agreed-upon form of compensation by the parties. The acquisition of land is critical since a slight delay in the acquisition of land required for the project could affect the entire schedule and viability of the project. The acquisition process can vary in time as it is dependent on factors such as the size of the project and the amount of political support given by the government towards the project.

**Change of law**

Dramatic changes of law through nationalisation or expropriation are a part of the sovereign risk of doing business in emerging markets. However, as stated above, much more subtle changes of law or regulations may have a significant impact upon project economics. For example, the host government may impose additional tariffs on imports of plant and machinery or materials, or the health and safety requirements may change during the course of construction, leading to design changes. Both scenarios may increase the cost of construction of the facility.

In recent years, there has been an increase in government-imposed environmental compliance requirements on companies in order to comply with new treaties and similar obligations. It is important to be clear on the level of risk the government should retain for risks flowing from discriminatory or sector specific changes in the legislation, such as more stringent air emission standards or higher-quality standards, which would have consequences for the public purse.

**Security**

It is important to understand the position under local law as to the granting, perfection, priority and enforceability of security and the level of certainty regarding the enforceability of step-in rights granted to the lenders. In some countries, such as China and Vietnam, effective security is available. However, the legal framework for taking the level of security commonly required in Western project financings is still evolving. Whether or not the security package will be comprehensive will depend on the available instruments to create the security under local law. It is worth confirming that on an enforcement of the lenders’ security, the lenders would have access to all the
assets of the company. For example, in Vietnam there are significant issues with enforcement and restrictions exist on taking security of immovable assets such as land use rights, buildings and properties attached to land. In other countries, legal structures may be more developed. However, there may still be difficulties associated with taking security. For example, in Thailand the nature of available security is very limited as there is no concept of a general floating charge, a concept frequently used in UK-based project financings.

So far as possible, all government consents and approvals should, right from the beginning, contemplate a security structure consistent with project financing practice.

ENVIRONMENTAL ISSUES

Western investors will be well aware of the need to meet certain environmental standards on infrastructure projects. It would be wrong to assume that this is a lower priority in Asian countries with undeveloped environmental policies. For example, both Malaysia and Thailand require environmental impact studies to be completed before environmental approvals can be obtained. The relevant authorities will often be unfamiliar with the environmental issues raised by the technology used in modern infrastructure projects and significant time may have to be spent satisfying the authorities on the issues involved.

Planning for environmental approvals should start from the beginning of the project, particularly if the project is looking for support from multilateral agencies, such as the World Bank and Asian Development Bank, which require environmental standards to be met as a condition of their involvement. For example, the International Finance Corporation has implemented detailed standards on a borrower’s environmental responsibilities when managing its project. The voluntary adoption of social and environmental standards by a wide range of financial institutions is not uncommon, such as the Equator Principles. As such, most large-scale projects are required to comply with a high standard of environmental principals if they hope to gain access to the financial markets.

CONCLUSION

Project finance has become, and will continue to be, an important method of raising funds for the infrastructure necessary to support the thriving economies in Asia. In addition, it has the added benefit of reducing the particular country’s exposure to international capital markets.

Nevertheless, the practical aspects, rather than the conceptual aspects, are the backbone of a successful project. Success depends not only on the ability of the project participants to identify, allocate and manage the risks they have accepted, but also on the ability of the participants to adopt and improve on structures they have used in the past to meet the challenges thrown up in this region. Participants must cast a critical eye over the structures they use and resist the impulse to insist on the inclusion of relevant structures and contract documentation simply on the basis that they worked well in the past, especially where the funds for those projects were raised from the sponsors “on balance sheet” and the current project differs in that it is funded through non-recourse or limited recourse project financing. This is particularly important in the emerging markets of Asia, where the regional, contractual and financing aspects of projects, including projects structured around the PPP model, are considerably more complicated than in Europe, the UK or the US.

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