PROJECT FINANCE

CHAPTER 4 | PROJECT FINANCE

Project financing is commonly employed to secure the necessary financing to develop large infrastructure and industrial projects in Thailand especially in the energy sector, e.g., power generation, mining projects, and pipelines. Project financing in Thailand was first introduced in 1990 with the development of the Map Ta Phut Industrial Estate by the Thai government in the eastern seaboard region located in Rayong Province. To this day, the Map Ta Phut Industrial Estate remains the largest industrial park in Thailand and the world's eighth-largest petrochemical industrial hub.

(1) What is "Project Financing"?

There is no standard definition of "project financing". Project financing can generally be described as long-term financing of infrastructure and industrial projects where lenders rely on the revenue generated by the operation of the project as the main source of funding to repay loans. In this regard, lenders will typically have limited recourse only to the project assets and cash flow generated by the project, rather than recourse against the project sponsors, save for limited exceptions due to the risk of such project.

Note that the project's feasibility is the main factor that lenders take into consideration in determining whether the project is "financeable" or not. Therefore, project sponsors must be prepared to face scrutiny from lenders. In addition to project feasibility, lenders will generally review various aspects of the project, which includes financial, technical, regulatory, legal, insurance, and environmental aspects. The wide range of aspects reviewed by lenders means that it is common for a project sponsor to engage a financial advisor, a technical advisor (who may also act as an environmental advisor), a legal advisor, a project manager, and an insurance advisor to assist in the credit evaluation process. Similarly, lenders will also appoint their technical advisors, legal advisors, and insurance advisors during the evaluation process of any project for project financing.

(2) Key Features of Project Financing

- **Use of a "special purpose company"**: a company established for the sole purpose of undertaking a specific project, which shields other assets of a project sponsor in case the project subsequently fails. A special purpose company usually owns the assets specific to each project.

- **Capital contribution commitments**: relevant to structuring an entity or an investment in an entity, these are typically obligations agreed to by project sponsors that are required to ensure that each project is financially sound, or to assure lenders of the sponsors'/owners' commitment. Capital contribution will be applied towards payment of project costs.

- **Set of project contracts**: a project finance mechanism used to allocate the risks among the various parties to each project. The contracts must efficiently allocate risks and rewards.

- **Loans**: typically, lenders will provide their commitments to disburse the term loan facility to finance part of the project costs during the construction period and the working capital facilities to finance working capital requirements of the project during the operation period. Lenders will commonly include a hedging facility in a project financing package to minimize risk arising from fluctuations in currency exchange or interest rates. Loans and other facilities provided by lenders are generally secured by all the project assets, including the revenue-producing contracts.

- **Risk identification and allocation**: a key component of project financing. A project may be subject to several technical, environmental, economic, and political risks. Following careful due diligence,

lenders will assume only measurable or measured risks and usually reserve the right to make key project decisions in the loan agreement.

(3) Project Financing Process

In the initial phase, the project sponsor, with assistance from a financial advisor, will typically prepare a memorandum that contains important information regarding the project and its financial model as well as a proposed term sheet for the project financing. A request for proposal (RFP) with the information memorandum and proposed term sheet attached will then be sent to potential lenders for consideration. There may be clarification sessions to answer questions which potential lenders may have about the project.

Lenders whose proposals are accepted by the project sponsors will then be mandated and will generally be identified as arrangers. Lenders, with the assistance of various advisors, will then conduct due diligence on the project until satisfied. Simultaneously, the term sheet and the financing documents will be negotiated by the parties involved until these documents are finalized and signed.

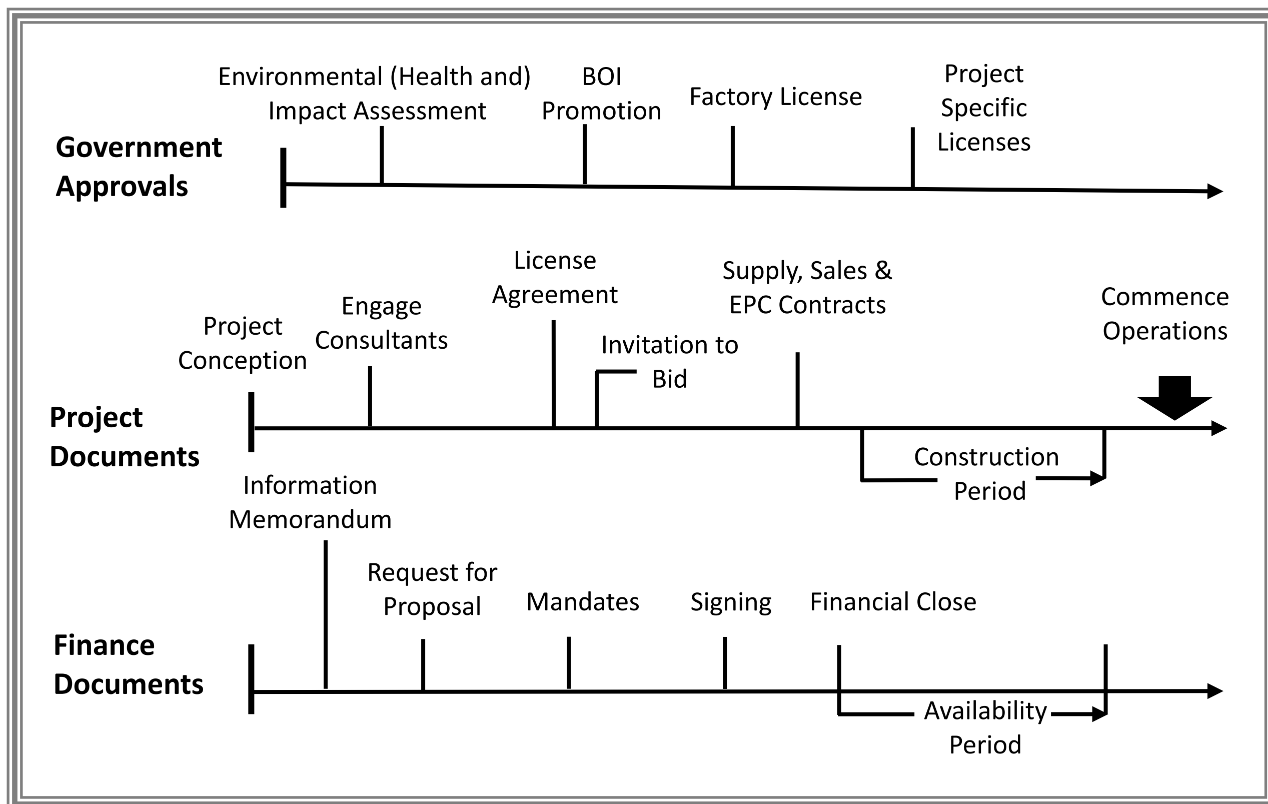
For the borrower to make the initial drawdown, the borrower must fulfill the condition precedents set out in the financing documents, which usually address concerns raised from the due diligence. Subsequent drawdowns of the loan will usually occur after a milestone in the construction of the project is achieved.

Lenders may also impose conditions subsequent that the borrower must satisfy after the initial drawdown. Failure to fulfill a condition subsequent would result in a drawstop (an event which gives the lenders the right to refuse to make further loan advances).

(4) Project Financing Timeline

The following diagram illustrates the timeline for a typical Thai project financing:

[Figure 4-1] Project Finance Timeline



(5) Major Financing Documents

A simple project financing transaction can be governed by a single credit agreement covering details of facilities provided, conditions precedent, utilization, repayment and prepayment, cancellation, accounts and cash flow application, representations, covenants, events of default, agency provisions, etc.

A complex financing transaction may involve more financing documents, e.g., common terms agreement, facilities agreements, accounts agreement, etc.

In relation to the financing documents, if the loan is denominated in foreign currency, the issue relating to the transition away from the London Interbank Offered Rate (LIBOR) should be taken into consideration.

For legacy contracts, a mechanism of substituting the LIBOR to an alternative reference rate should be added. The parties must have a good understanding of and discuss the commercial and legal impacts that may arise from applying an alternative reference rate, and properly address those in the financing documents.

(6) Major Sponsor Documents

Lenders in project financing are expected to review the shareholders' agreement among project sponsors to ensure that there are no provisions that may adversely affect the rights of the lenders.

Project sponsors are commonly required to enter into an equity contribution agreement, which is an agreement where project sponsors undertake to inject a capital contribution into the project company when required. If the project sponsor's financial strength is not acceptable to the lenders, its parent group or company may be required to enter into an equity guarantee agreement to support the obligation of the project sponsor to make such a capital contribution, or may be required to place capital contribution security in the form of standby letters of credit issued by financial institutions having acceptable minimum international credit ratings by international rating agencies such as Standard & Poor's, Moody's, and/or FITCH.

In certain cases, a sponsor support agreement may also be required by lenders. A sponsor support agreement is an agreement where project sponsors undertake to provide support to the development of the project in case of cost overrun and cash deficiency, as well as technical and managerial support to the project company.

Each project sponsor may also be required to enter into an equity subordination agreement with the lenders.

(7) Major Security Documents

Loans are generally secured by all the project assets. A typical security package as required by lenders for Thai project financing may include the following:

(i) land and building mortgage;
(ii) machinery mortgage;
(iii) sponsor support agreement for cost overrun support and cash deficiency support;
(iv) share retention agreement;
(v) share pledge agreements in the project company;
(vi) share pledge agreements in the holding company;
(vii) assignments and conditional novation of project agreements, and consents of counterparties;
(viii) security under the Business Security Act, B.E. 2558 (2015) (also known as the Secured Transactions Act) cover:
   a. bank accounts;
   b. machinery and equipment; and
   c. rights to receive revenues;
(ix) pledge of permitted investments;
(x) assignment of insurances and reinsurances; and
(xi) insurance broker undertaking.

For further details of security available under Thai law, please refer to Chapter 5 (*Security*).

(8) Major Project Documents

In developing a project where project financing will be employed, major project documents in relation to the project may include a site acquisition contract, project management contract, technology license contract, engineering, procurement, construction ("**EPC**") contract, supply of raw

material contract, sale of goods contract, logistics and management contract, and/or insurance contract.

Project sponsors should ensure that major project agreements meet the expectations of lenders. In general, lenders pay special attention to counterparty risk, payment terms (retention, payment curve vs. work curve, etc.), size of liquidated damages, tax planning, performance security (bank guarantee, standby letter of credit, retention, etc.), termination and suspension risk, recognition of lenders' rights in connection with assignment as security and terms of "direct agreement" with lenders, insurance (contractor's cover vs. owners' cover) as well as governing law and dispute settlement.

A common practice by lenders is to, among others, require access to the site, the right to receive periodic reports, notices of specific events (claims, proposed change order, force majeure, etc.), approval rights regarding specific actions (increase in contract price, extension of time, right to terminate/suspend, etc.). In addition, all rights under the performance bonds and other performance security under the major project documents will be required to be assigned to lenders as part of a security package.

To protect lenders from risks under the major project documents, a "drawstop" is usually stipulated in the financing documents for occurrences of certain events under the major project documents, e.g., delays in the acquisition of right-of-way or delays in achieving major construction milestones.

Note that poor contracting practices to the major project documents can result in delays to the project due to a lender's requirement to amend such major project documents, request for additional guarantees to cover contingent tax liabilities arising from inadequate tax planning in EPC contracts, and request for higher levels of sponsors' support as well as increases in the cost of borrowing due to higher risk to lenders and more restrictive covenants in the financing documents. The lack of coordination between the contracting counterparties and absence of an effective dispute resolution mechanism may also result in a delay and higher project costs.

(9) Equator Principles

For project financing where international financial institutions are involved, a key factor in determining if a project is financeable is whether the project complies with the "Equator Principles". The Equator Principles originated from a meeting of banks led by the International Finance Corporation in London in October 2012. The purpose of the meeting was to review environmental and social issues in project financing. As a result, the Equator Principles were developed in 2013. They serve as a common global baseline and framework for the assessment of environmental and social issues for project financing in various sectors. The Equator Principles are primarily intended to provide a minimum standard or benchmark of due diligence to support responsible risk decision-making.

The Equator Principles are applicable for projects with capital costs of at least USD 10,000,000.

There are currently 124 financial institutions in 37 countries that have adopted the Equator Principles. No Thai banks have adopted the Equator Principles as of September 2021.

Project sponsors pursuing project financing from lenders who are international financial institutions need to ensure that they can comply with the Equator Principles.

(10) Key Government Approvals

Project sponsors need to ensure that key government approvals are obtained as and when required in each stage of the project in a timely manner as lenders will usually impose a milestone for obtaining each key government approval to ensure smooth construction and operation of the project.

Key government approvals in a common Thai project financing includes an Environmental Impact Assessment (EIA) or Environmental and Health Impact Assessment (EHIA) report (and public participation requirements, if applicable), investment promotion (BOI), factory license, and project specific licenses.

Lenders will normally impose a “drawstop” in the case of delays in obtaining specific government approvals.

(11) Insurance Requirement

Project sponsors must ensure that the project has a proper insurance package during the construction period of the project which is acceptable to the lenders. The procurement of the insurance package is usually a condition precedent to initial drawdown of loans. An agreed insurance program in place is also important during the operation period approved by lenders. In this regard, lenders will also generally require that they be named as co-insured and sole loss payees as well as requiring assignment of all insurance (and reinsurance, for large scale projects) policies to the lenders as security.

Note that in practice, lenders may also require owner-cover insurance to ensure that the owner of the project has control over all insurance matters for the project.

(12) Accounts and Cash Waterfall

One of the key features of project financing transactions in Thailand is that lenders will closely monitor all cash flow during the construction and operation periods. Depending on the restrictiveness of the provisions, a default or an acceleration will stop cash flow until lenders determine otherwise.

Usually, all bank accounts will be located in Thailand. However, if there is an overseas lender involved or if the project is located overseas, e.g., power plant project in Lao PDR owned by Thai investors, certain bank accounts may be offshore accounts.

(13) Debt-to-Equity Ratio

A debt-to-equity ratio is a ratio used to measure a company’s financial leverage, calculated by dividing a company’s total liabilities by its shareholders’ equity, which may be in form of capital contributions or shareholders' loans. The debt-to-equity ratio indicates how much debt a company is using to finance the project relative to the amount of value represented in shareholders’ equity.

Lenders in a Thai project financing are typically willing to provide loan commitments at a higher ratio than capital contribution commitments by project sponsors, particularly project financing to energy projects.

(14) Dispute Resolution

Dispute settlement, especially in a project financing involving international financial institutes, can be an important issue for discussion. Unlike many other jurisdictions, the Thai courts will not enforce a foreign court judgment. A common solution implemented to such practice is to specify that any disputes under the financing documents will be settled by arbitration in a neutral jurisdiction such as Singapore. Since Thailand is a party to The New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958), Thai courts will enforce foreign arbitration awards if the criteria set out in the Convention and in the Arbitration Act, B.E. 2545 (2002) is met.

(15) Sector Use of Project Finance Structures

Project financing structures are commonly used in large-scale infrastructure projects, power plants, oil and gas, and mining projects. The project company will be required to comply with various licensing and permitting requirements, depending on the sector, and it will be vital for the lenders to have a clear and comprehensive understanding of the regulatory regime in each sector. Understanding the specific legal regime of such sector will also allow lenders to better assess the project company's ability to monetize the project and most importantly, the possibility for lenders to recoup their investment.

A. Electricity Generation

Private power producers generally enter into power purchase agreements (PPAs) with the Thai government utilities, i.e., the Electricity Generating Authority of Thailand (EGAT), the Metropolitan Electricity Authority (MEA) or the Provincial Electricity Authority (PEA), who are the main purchasers and distributors of power in Thailand. PPAs entered into with such government utilities are generally considered bankable.

For more information on laws relating to electricity generation in Thailand, please see Chapter 6 (*Energy and Natural Resources*).

B. Oil and Gas

Petroleum producers commonly use some form of a project financing structure. Traditionally, the only way to produce petroleum in Thailand has been by way of a concession, granted by the Ministry of Energy) to a concessionaire. Unlike other sectors where sponsors will establish a single specific purpose company to own and operate the project and its assets, petroleum producers generally establish unincorporated joint ventures, with one of the co-venturers acting as the operator of the project.

For more information on the laws relating to oil and gas in Thailand, please see Chapter 6 (*Energy and Natural Resources*).

C. Infrastructure Investment

An important legislative item that is relevant to project financing is the Public Private Partnerships Act, B.E. 2562 (2019) ("**PPP Act**"), which came into effect on 11 March 2019. The PPP Act governs government projects that involve participation and investment from private parties.

The State Enterprise Policy Office of the Ministry of Finance is responsible for administration of the PPP Act.

Both project sponsors and lenders will need to ensure that a project, which falls under the PPP Act, complies with all the requirements under the PPP Act.

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