THE FUNDAMENTALS OF PROJECT FINANCE

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OVERVIEW

- PROJECT FINANCE CHARACTERISTICS
- PROJECT RISKS
- PROJECT CONTRACTS

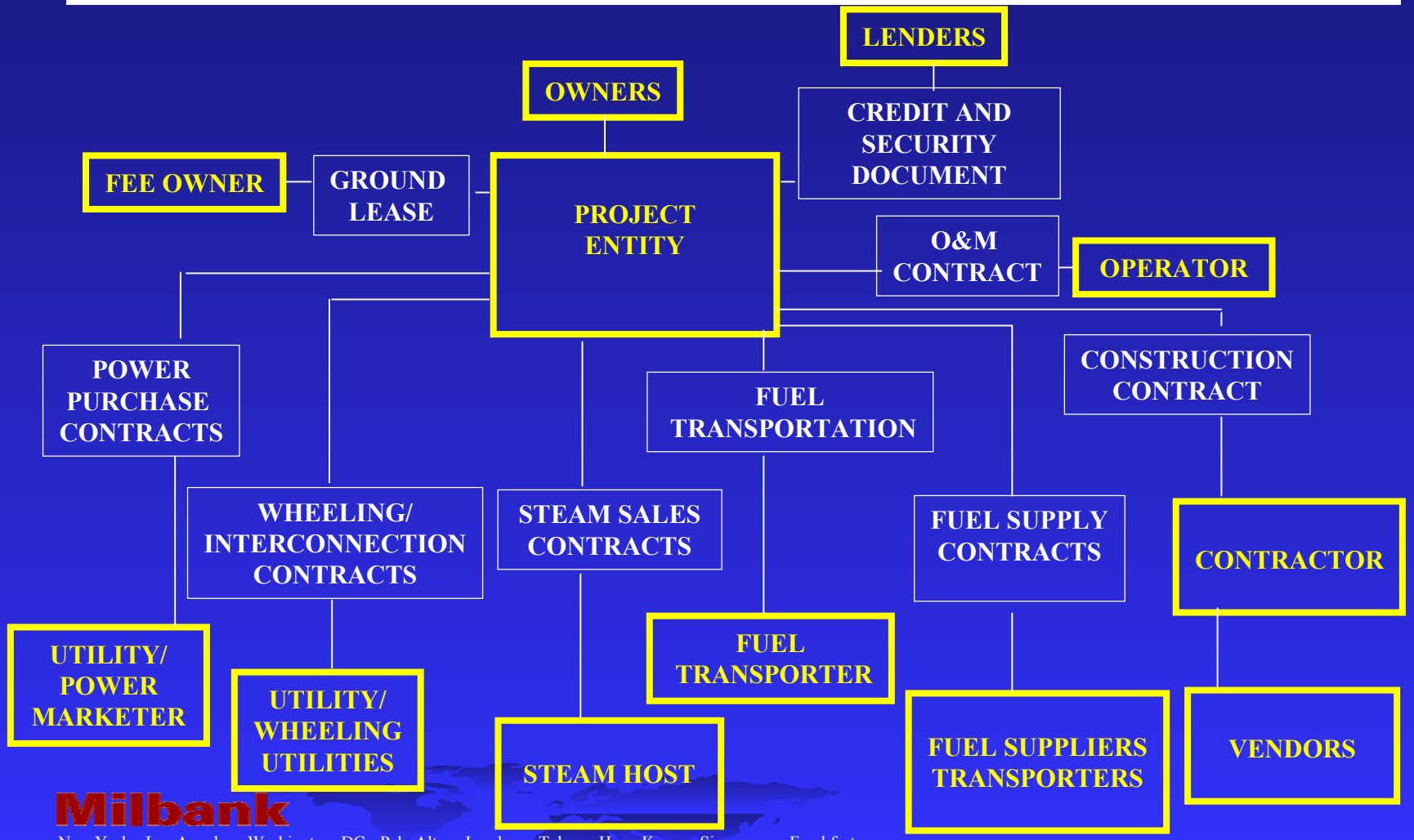
CHARACTERISTICS PROJECT FINANCE

- SPECIAL PURPOSE PROJECT ENTITY
- HIGHLY LEVERAGED, LONG-TERM CAPITAL STRUCTURE
- DEBT IS NON-RECOURSE (OR LIMITED RECOURSE) TO SPONSORS

CHARACTERISTICS PROJECT FINANCE (Continued)

- RISK ALLOCATION AND CREDIT SUPPORT PRINCIPALLY FROM CONTRACTS
- LENDER HAS SECURITY IN PROJECT ASSETS AND CONTRACTS

PROJECT CONTRACTS



KEY ISSUES

- RISK IDENTIFICATION, ALLOCATION AND MITIGATION
- BASIC COMMERCIAL TERMS
- MACROECONOMIC AND POLITICAL ISSUES
- LEGAL AND REGULATORY ISSUES

PROJECT RISKS

- TECHNOLOGY
- COMPLETION
- REVENUE/FRANCHISE
- SITE
- SUPPLY
- OPERATION
- ENVIRONMENTAL
- MANAGEMENT

PROJECT RISKS (Continued)

- FORCE MAJEURE
- ECONOMIC CONDITIONS
- DEMAND FOR PRODUCT
- POLITICAL STABILITY
- REGULATORY REGIME
- LEGAL SYSTEM
- CURRENCY AVAILABILITY/CONVERTABILITY

REVENUE RISK

- LONG-TERM PURCHASE CONTRACT
  - Power Purchase Agreement/Power Marketing Agreement
  - Waste Service Agreement
- MARKET RISK
  - Merchant Power Project
  - Airport
  - Telecom Project
  - Amusement Park

REVENUE RISK (Continued)

- FRANCHISES AND CONCESSIONS
  - Toll-road franchise
  - Port Concession
  - Oil and gas exploration and production
  - Telecommunications licenses
- EXCLUSIVE RIGHTS
- GRANTED BY GOVERNMENT

PROJECT CONTRACTS

- OFF-TAKE CONTRACTS
- CONSTRUCTION CONTRACTS
- OPERATION CONTRACTS
- SUPPLY CONTRACTS

POWER PURCHASE AGREEMENTS

- DELIVERIES/DISPATCH
- CONSTRUCTION STANDARDS
- OPERATING STANDARDS
- INSURANCE
- INTERCONNECTION
- METERING AND PAYMENT

CONSTRUCTION CONTRACTS

- SCOPE OF WORK
- CONTRACT PRICE
- PAYMENT SCHEDULE
- COMPLETION SCHEDULE
- CHANGE ORDERS

CONSTRUCTION CONTRACTS (Continued)

- PERFORMANCE TESTS AND GUARANTEES
- LIQUIDATED DAMAGES/LIMITS ON CONTRACTOR LIABILITY
- WARRANTIES
- DEFAULTS AND REMEDIES

OPERATION CONTRACTS

- TERM
- COMPENSATION - COST vs. INCENTIVE
- SCOPE OF WORK
- STAFFING
- PERFORMANCE STANDARDS
- AUTHORITY OF OPERATOR

SUPPLY CONTRACTS

- TYPES
  - Requirements
  - Output
  - Take or pay
  - Backup
- SELLER CREDITWORTHINESS
- CONDITIONS PRECEDENT

SUPPLY CONTRACTS (Continued)

- PRICE (HEDGE TO REVENUES)
  - Fixed
  - Market
  - Escalation
- QUANTITIES TO BE DELIVERED
- QUALITY OF SUPPLY

SUPPLY CONTRACTS (Continued)

- DELIVERY TERMS
  - Delivery point and title transfer
  - Transportation
  - Insurance
- INCOTERMS

MARKET TRENDS AFTER ENRON

- Concerns over the appearance of using special purpose entities for financings/accounting practices under scrutiny
- Rating agencies requesting more information about debt incurred by SPEs
- Sponsor credit support: guaranty/letters of credit/performance bonds
- Project credit support: larger reserves/holdbacks
- Off-balance sheet structures getting more scrutiny

CONCLUSION

- IDENTIFY, MITIGATE AND ALLOCATE PROJECT RISKS
- CLEARLY DEFINE GOALS
- KNOW YOUR EXIT STRATEGY
- KNOW YOUR MARKET

QUESTIONS?

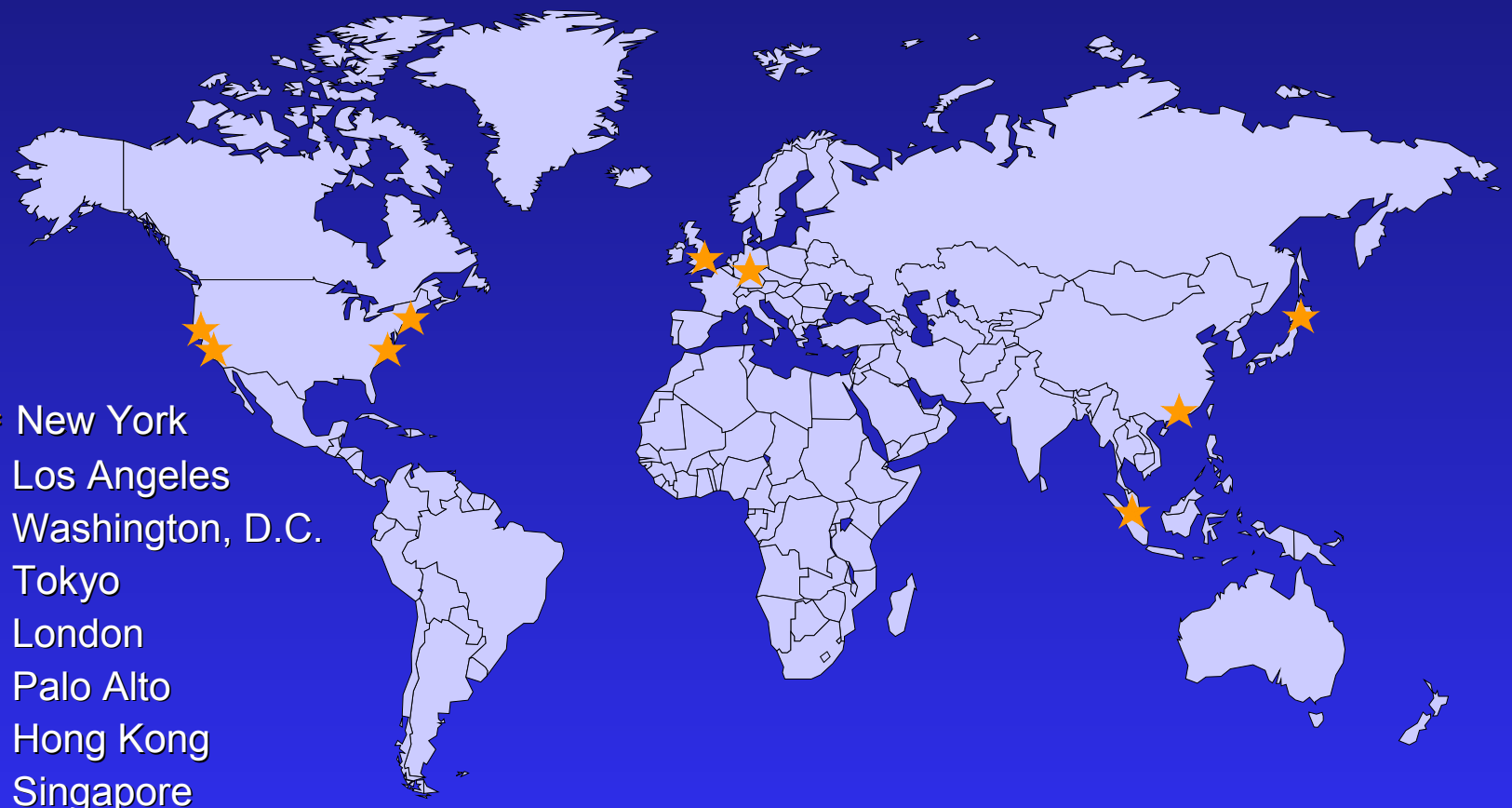
MILBANK GLOBAL PROJECT FINANCE TEAM

- OFFICES IN NEW YORK, LOS ANGELES, PALO ALTO, WASHINGTON, D.C., LONDON, HONG KONG, SINGAPORE, TOKYO AND FRANKFURT
- OVER 100 PROJECT FINANCE LAWYERS GLOBALLY
- U.S. AND ENGLISH LAW CAPABILITY

GLOBAL LEADER IN PROJECT FINANCE

- Power, telecoms, mining and natural resources, petrochemical, pipelines, paper, transportation, environmental, oil and gas, satellites
- More than 120 project financings (debt and equity) with aggregate capital cost exceeding $80 Billion
- Ranked three consecutive years by *Privatisation International* as the most active law firm in the world engaged in private financing of infrastructure projects

MILBANK'S OFFICES



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