

**PRIVATE POWER PROJECT DEVELOPMENT  
FINANCIAL DOCUMENTATION**

Prepared for

His Majesty's Government of Nepal  
Ministry of Water Resources  
Electricity Development Center

Under the

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## Abbreviations and Acronyms

BLT	Build-Lease-Transfer
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
EDC	Electricity Development Center
EPC contract	Engineering, Procurement and Construction Contract
FERC	Federal Energy Regulatory Commission (United States)
HMG/N	His Majesty's Government of Nepal
IPP	Independent Power Producer(s)
kWh	Kilowatt Hour
kW	Kilowatt
MIGA	Multilateral Investment Guarantee Agency (member of the World Bank Group)
NEA	Nepal Electricity Authority
O&M	Operation and Maintenance
OPIC	Overseas Private Investment Corporation (United States)
PA	Project Agreement
PPA	Power Purchase Agreement
USAID	U S Agency for International Development
USEXIM	Export-Import Bank of the United States

## Executive Summary

Despite its vast water resources, financial constraints have prevented Nepal from developing its water and power sectors, and particularly those hydroelectric projects which could help expand the economy of the country significantly. Major factors contributing to these constraints include the reduction in donor resources and the increasing cost of large scale projects. The investment costs required to develop the water and power sectors are significant and far exceed the financial resources currently available to HMG/N.

Realizing that Nepal must continue to meet the ever growing demand for electricity, but at the same time noting that funding may not be available from traditional public sector sources, His Majesty's Government of Nepal is developing these natural resources using a combination of both public and private financing. The Electricity Development Center has a mandate to facilitate the development of sustainable hydroelectric power projects through private participation. The Electricity Development Center is required to advise His Majesty's Government of Nepal on, among other matters, the implementation of innovative private sector investment techniques.

This report has been written by the Private Power Contract/Legal Specialist as an introduction to and overview of the financial documentation required in the implementation of power projects undertaken by the private sector. The project finance approach is the basis of such implementation. The report should be read in conjunction with the report prepared by the Financial Contract Specialist which provides a financial model for the project finance approach and covers the financial analysis, risk analysis and risk mitigation of projects.

### Project Finance

Project finance is a financing approach whereby debt is mobilized on the basis of the performance of a specific project rather than on the strength of an existing company's balance sheet. The lenders look mainly to the project cash flows to repay debt. An overview of four major items affecting satisfactory financial closure in a project finance power project transaction is given in this report. These four items are project or implementation agreements, power purchase agreements, risk and the documentation necessary for financial closing. They are each dependent on the other and are briefly described below.

### Project Agreements

A project agreement is a project specific document that consolidates in one document the government assurances and guarantees to private developers required for successful project development and allocation of risk.

### Power Purchase Agreements

A power purchase agreement is a project specific document which sets out the operating characteristics and the pricing of electricity production by the project company that is sold to a purchasing entity. Because the power purchase agreement in a project finance arrangement provides the only revenue stream for repayment of debt and return to investors, it is extremely important to lenders.

### Risk

Privately financed power projects involve risk for all parties - the power purchaser, project developer, and lenders. The main categories of risk are commercial, political or country, financial and legal. Successful mitigation of risk is critical to the financial feasibility of a project.

### **Documentation for Financial Closing**

Financial closing occurs when all agreements have been executed, the financing arranged and disbursements from the proceeds of the financing can take place. Main categories of documents are transaction documents, project documents, insurance documents, security documents, corporate documents, approvals, licenses and permits, legal opinions and miscellaneous closing documents.

### **Recommendations**

The legal and financial staff of EDC should be given suitable training, in seminars and by other means, in the documentation and other aspects of project finance discussed in this report.

EDC should strengthen their legal expertise to be able to deal with foreign developers who are assisted by international law firms with great experience in the project finance approach.

EDC should select a project to do as a solicitation and prepare a solicitation document with the aid of the presently available assistance with regard to financial, legal, and technical expertise.

# **1 Introduction**

## **1.1 Purpose of the Report**

This report sets out the results of a review of the financial documentation, including project agreements and power purchase agreements, required for the implementation of power projects financed by the private sector. Risk in relation to such privately financed projects is discussed. A list of the documentation required for financial closure is included. This report should be read in conjunction with the report prepared by the Financial Contract Specialist which provides a financial model for the project finance approach and covers the financial analysis, risk analysis and risk mitigation of power projects. Both reports have been prepared under the United States Agency for International Development (USAID) Private Electricity Project (PEP) for the Electricity Development Center (EDC) of His Majesty's Government of Nepal (HMG/N).

## **1.2 Background**

Despite its vast water resources, financial constraints have prevented Nepal from developing its water and power sectors, and particularly those hydroelectric projects which could help expand the economy of the country significantly. Major factors contributing to these constraints include the reduction in donor resources and the increasing cost of large scale projects. The investment costs required to develop the water and power sectors are significant and far exceed the financial resources currently available to HMG/N.

Recognizing these constraints, HMG/N has attempted to accelerate hydropower development by opening the power sector to private development and investment. Enactment of the Electricity Act and the Water Resources Act in 1992, together with the adoption of policies affording incentives to potential producers signalled a focussed effort to develop private participation in such projects. Under the Electricity Act, a separate agency evolved, the Electricity Development Center (EDC), which is charged with the responsibility of oversight of all private electricity generation projects larger than 1 MW, and with the oversight of transmission and distribution line facilities. Regulations were adopted in 1993 regarding the application, licensing, and monitoring process as set forth in the various Acts and Policies.

The Electricity Act 2049 and the implementing regulations contained in the document Electricity Regulation 2050 provide authority and responsibility to EDC for reviewing applications and making recommendations to HMG/N regarding the issuance of licenses for the construction and operation of generation facilities. EDC must provide such recommendations based on facilities that are not only cost effective, in terms of capital cost, but constructed and operated according to sound industry standards for safety and maintenance. The implementing regulations require the mode of finance for projects to be examined prior to award of a production license. It should be noted that the submission of financing documents by project companies is a requirement of many power purchase agreements.

## **1.3 Terms of Reference**

The Terms of Reference for the Private Power Contract/Legal Specialist require the Specialist to work with EDC staff, and others, to formulate recommended contract language and model contract components for use in requisite legal documentation for solicited and unsolicited proposals in the private sector of Nepal. Besides the traditional

contracts concerning the power purchase agreement and project agreement, the consultant will develop the matrix of necessary financial and legal documents required for completion of project financing and operation

The Private Power Contract/Legal Specialist will review existing contract legal provisions, including relevant acts, regulations, and policies of HMG/N regarding the financial and promotional guidelines, including the current policies with respect to private sector participation, and current regulations with respect to their appropriateness based on experience in other countries. The Specialist will be responsible for compiling a list of the documents, a project closing checklist, required for a typical financial closing and, where possible and where appropriate, provide samples, in form and substance of the representations and warranties which will be required by private developers and their lending agencies

Specific tasks are as follows

- ▶ Compare terms and conditions of proposed power purchase agreements and project agreements between other countries and private developers as compared to the terms and conditions of contemplated power sales agreements and project agreements currently being examined or processed by EDC
- ▶ Assist in the drafting of standardized power purchase and project agreement terms and conditions
- ▶ Identify any issues or topics within the power sales agreements and the project agreements for additional legal review with the goal of adopting standard contract language that will be consistent with the requirements of foreign developers while maintaining compliance with existing Nepalese laws, acts and regulations
- ▶ Liaise with the Financial Contract Specialist regarding the development of pricing risk strategies and implications in the development of such standardized power purchase and project agreement terms and conditions
- ▶ Develop a “checklist” for documentation necessary to effect a financial closing between private developers and their financial lending institutions, including, where appropriate, suggested formats and a discussion as to the reasons for such documentation

One of the aims of the EDC is to develop over a period of time suitable standardized contract format language for use in power purchase agreements and project agreements for solicited as well as unsolicited proposals. Such language must effectively apply the representative terms and conditions as set forth in implementing policies, legislation and acts, while at the same time being of a form that will be acceptable to developers and international lending agency standards

## **1 4 Outline of Report**

This report is an introduction to and overview of the financial documentation required in the implementation of power projects undertaken by the private sector

The development of power projects in the private sector is generally carried out on the basis of the project finance approach. This approach is described in Section 2 of this report. Four major items that are critical to this approach are then discussed as follows

- ▶ Section 3 Project Agreements
- ▶ Section 4 Power Purchase Agreements
- ▶ Section 5 Risk
- ▶ Section 6 Documentation for Financial Closing

Conclusions and recommendations are given in Section 7 and references in Section 8

An extensive set of terms and definitions relating to project finance is given in Appendix A, Glossary

It should be noted that this report gives an overview of the documentation associated with the project finance approach. The discussion given for each topic is a guide and should not be construed as having any legal standing. Sample clauses, tables of contents, and lists of requirements, obligations, and commitments are provided as examples only and are not to be considered as applying to all cases. They are, however, typical of the public and private sector, and the degree to which they can be explicitly addressed and negotiated will be reflected in the viability of the project.

## 2 Project Finance

### 2.1 Definition and Approach

Private power projects are generally undertaken on a “project finance” basis. Project finance refers to a range of financing structures whereby lenders depend on the performance of the project itself for repayment, rather than on the credit of the sponsor. It is also sometimes called non-recourse or limited recourse financing. These terms refer to the fact that lenders have either no recourse or only limited recourse to the sponsors for repayment of loans.

Project finance normally involves the following elements:

- ▶ Lenders’ reliance on the cash flow of the project for repayment without full recourse to the sponsor
- ▶ Thorough technical and financial evaluation of the project by lenders, including the source of revenue stream, construction contractors, equipment suppliers, operating arrangements and other project features that are key to maintaining adequate cash flow for debt service
- ▶ Complex loan and security documentation, often involving several lenders and investors
- ▶ A detailed process of risk allocation amongst participants

Project finance structures have appeal primarily because they allow sponsors to undertake investments that they otherwise would not be able to make on the strength of their own balance sheet. In this way, they can leverage their resources and expertise in pursuing profitable investment opportunities.

A second important reason is the risk sharing which is achieved through project finance structures, where sponsors share project risks with lenders. If the project fails, lenders absorb any losses suffered along with the sponsors.

Other reasons for the project finance approach include possible tax benefits for the sponsors, and favorable accounting treatment resulting from categorizing project finance investments as off balance sheet, thereby limiting a company’s debt exposure.

Private power projects are generally developed under the Build-Own-Operate-Transfer (BOOT) method rather than the Build-Own-Transfer (BOT) arrangement. This is to ensure that the project is fully controlled by the project developer and to mitigate operational risk.

Projects are generally financed with a combination of debt and equity. Debt is a portion of project finance in the form of interest-bearing loans which have definitive repayment schedules. The interest rates for these loans are based on risk and term. Equity is that portion of the project finance generally provided up front, the return on which is not fixed, but is calculated on the net profit after all debt payments, operation and maintenance expenses, royalties, taxes and other payments have been made. Often, sponsors will arrange construction financing to cover

the construction phase of a project which is normally taken out by equity and long term debt financing once a project is commissioned

The basic project finance approach is described above. Outside the scope of this report are such items as the phasing of loan amounts, the effects of multiple lenders, and the use of variations to the approach such as sale/leaseback transactions

## 2.2 Participants

As indicated above, in the project finance approach to privately financed power projects, lenders depend on the performance of the project itself for repayment rather than on the credit of the sponsor. Nevertheless, the sponsor is the focus of the activity in putting together the transaction. There are a number of participants in such a project finance transaction, each of whom assumes risks to varying degrees in the project development. A major part of the documentation associated with a project finance closing has to do with the allocation and mitigation of risk amongst the various participants.

The main participants are

- ▶ **Sponsor or Developer** The sponsor takes the leading role in structuring the project. He negotiates the various project agreements (project agreement, power purchase agreement, and other documents), arranges the financing, negotiates and secures the construction and equipment supply contracts, and other items associated with project development. The sponsor may also supply some of the equity financing, depending on the size of the project and on other factors particular to the sponsor. A sponsor will generally set up a sole-purpose company, or project company, to assume legal and financial responsibility for the design, construction, commissioning and operation and maintenance of the project. Recourse of the creditors in the event the project fails is then limited to the project company's accounts.
- ▶ **Equity Investors** These are individuals, groups, or companies that invest equity in a project company.
- ▶ **Lenders** Commercial banks or other lending institutions such as insurance companies that provide secured loans or other types of loans to the project company. Lenders typically provide the construction finance and the subsequent long-term debt financing.
- ▶ **Power Purchasers** These may be government or investor owned utilities, cooperatives, industrial concerns or similar entities.
- ▶ **Government Agencies** These are involved in the provision of government assurances and guarantees and of such items as licenses and permits.
- ▶ **Construction Contractors and Equipment Suppliers** These contractors and suppliers build, provide the necessary equipment, and commission the power project. Often, they are combined under one engineering, procurement and construction contract.
- ▶ **Operation and Maintenance Contractor** Operate and maintain the project following completion and commissioning.

## 2.3 Documentation

The purpose of the documentation associated with the project finance method of implementing private power projects is to allocate and mitigate the risks amongst the participants by establishing legally binding obligations, financial structures, and operational procedures. The basic documents involved, often referred to as the “Security Package,” are as follows:

- ▶ Project Agreement
- ▶ Power Purchase Agreement
- ▶ Production License
- ▶ Ownership Structure and Agreements
- ▶ Land Conveyance Agreements
- ▶ Construction and Equipment Supply Contracts
- ▶ Supply Agreements
- ▶ Operations and Maintenance Agreement

The above contracts and agreements must be in place before financial closing can occur, construction can start, and loan funds can be disbursed. Prior to financial closing, the lenders will wish to be satisfied that all the main agreements meet their requirements and have been executed. Lenders may want legal opinions, independent engineering reports, and copies of government approvals. In addition, they will want to confirm that the parties to each agreement are creditworthy and capable of performing under the terms of their respective contracts. Lenders look to the documentation to provide security for the loan, and in the event of a breach of any of the agreements they may seek the right to take over the company and install their own managers within the framework of the agreements.

Also, as part of the documentation to be in place prior to financial closing, lenders will require provisions to assign title to the project, including the appropriate agreements, to the lender by the developer. This is in effect a mortgage agreement whereby the project and documents are mortgaged to the lender until the long term debt is repaid.

## 3 Project Agreements

### 3.1 Purpose and Background

A project agreement is a project specific document that consolidates in one document the government assurances and guarantees to private power developers required for successful project development and allocation of risk. It is one of the principal documents negotiated where governments pursue a "one window" policy to encourage private development of projects. Other names for project agreements are implementation agreements, state support agreements or concession agreements.

A project agreement may contain a variety of commitments, inducements, and guarantees that can be given only by the recognized governmental authority. Examples of such issues are:

- ▶ Authorization to do business
- ▶ Granting of certain tax benefits
- ▶ Exemptions from customs duties
- ▶ Appropriate commitments by government required by lenders in areas that could affect the project company, where government policy has not been established

Often, the project agreement will contain terms and conditions necessary to ensure the effectiveness of other key project agreements, such as the power purchase agreement or, in the case of a thermal or cogeneration plant, the fuel supply agreement. In effect, the project agreement seeks to guarantee the performance of government entities involved in the project. The power purchase, fuel supply, and other agreements and documents have interlocking terms and conditions and need to be supported by the project agreement, since lenders are particularly concerned about government actions that might jeopardize their loans or investments. Moreover, in projects with long payback periods, this concern is compounded in host countries that lack a record of strong support for political, regulatory, economical, and financial reforms.

If the legal, institutional, political, and regulatory environments are conducive to private power development, the project agreement may be relatively simple and straightforward. Moreover, if the public sector is not a party directly involved in the obligations to private power developers, a project agreement would not be required. However, in such a case, the risks that would have been transferred to the public sector must be shared, in some form, among the private parties, both power producer and purchaser.

### 3.2 Terms and Conditions

Sample issues covered in a project agreement include, but are not limited to, the following:

#### 3.2.1 Government/Purchaser Commitments

(a) **Authorization to do Business in the Country**

A basic provision that recognizes and authorizes the project company to implement a private power generating facility.

- (b) **Authorization to Generate, Transmit and/or Distribute Electrical Energy**  
This provides for the project company to generate and possibly transmit and distribute electrical energy under certain controlled conditions
- (c) **Authority to Obtain Permits**  
Allows project company to secure construction permits, operating permits, if in compliance with related laws and regulations
- (d) **Guarantee of Performance - Sovereign Guarantee**  
Guarantee of performance of project company, fuel supplier, or other public sector entities who are party to the implementation and operation of the project means that the government, via a sovereign guarantee, compensates the project company for failure of one or more of the public sector entities to perform per agreement
- (e) **Currency Protection**  
Currency protection to the power supplier for a variety of currency issues, including convertibility, availability of foreign exchange, devaluation and repatriation
- (f) **Tax and Duty Incentives**  
Can be provided by creating decreases and /or total exemption from tax and duty obligation
- (g) **Changes in the Law and Regulations**  
Legislative protection against changes in the law and regulations which would adversely affect or potentially affect the participants in the project
- (h) **Force Majeure**  
Financial protection against certain force majeure events such as war, insurrection, and general strikes Force majeure should cover only exceptional circumstances and not normal business risks It should be noted that there may be relief of performance obligations under a force majeure situation but no relief from payment obligations Such risk is shared between the developer and the purchaser
- (i) **Work Permits**  
Work permits and visas authorize import and use of specified foreign work force

### **3 2 2 Private Power Developer Commitments**

- (a) **Laws and Regulations**  
Comply with laws and regulations of host country
- (b) **Project Development**  
Undertake project development including feasibility studies, permits, licenses, agreements, financing arrangements, design, construction, commissioning and operation and maintenance
- (c) **Project Financing**  
Obtain project financing and achieve financial close within specified parameters including time

(d) **Descriptions**

Describes form of company, ownership, registration, and terms of ownership

(e) **Insurance**

Project insurance to be obtained such as workmen's compensation, fire, auto, theft, business interruption, political risk and currency risk

### 3 2 3 Mutual Obligation/Commitments

(a) **Termination**

Termination defines under what conditions one party or the other can terminate the project agreement and the recourse should termination occur

(b) **Penalties**

Penalties define type, form, value of penalties imposed should a party fail to perform For example, liquidated damages may be applied for events such as late completion of construction

(c) **Governing Law and Arbitration**

The governing law of the agreement is generally the law of the host country Arbitration is usually performed under rules of an international agency This is further discussed in Section 4, Power Purchase Agreements

(d) **Loss and Damage**

The government and project company will mutually secure the other party against loss and damage arising from the performance of contractual obligations within certain limitations

(e) **Language**

Generally English is the recognized international language for documents such as project agreements

### 3 3 Government Policies, Acts, and Rules

HMG/N has established the framework for private development by means of the following policies, acts and rules

- ▶ Hydropower Development Policy, 2049 (1992)
- ▶ Water Resources Act, 2049 (1992)
- ▶ Foreign Investment and One Window Policy, 2049 (1992)
- ▶ Industrial Policy, 2049 (1992)
- ▶ Electricity Act, 2049 (1992)
- ▶ Electricity Regulation, 2050 (1993)

Some of the more specific incentives to enhance the anticipated development of hydroelectric power resources in the private sector include

▶ **“One Window” Policy**

The Electricity Development Center (EDC) is the agency responsible for all licensing, assistance, coordination and ongoing interactive authority for all projects licensed under the recently enacted legislation

▶ **Licensing Provisions**

Under the current regulations a license for survey is issued within 30 days of application with the license in effect for up to five years. This enables the developer to perform the necessary technical studies, negotiate a project agreement and a power purchase agreement, arrange for the financing, and finally apply for a production license. Production licenses for construction and operation of power projects and can be awarded for periods of up to fifty years

▶ **Water Rights**

License provisions give the licensee exclusive rights for the use of water for the project. Such water rights are specified as to the location and specific quantity required for the licensed project

▶ **Environmental Requirements**

All projects must comply with the existing rules and regulations regarding environmental impact mitigation and must be developed without substantial adverse environmental impact

▶ **Public Participation**

HMG/N requires the public involvement in the development of new projects. Under current provisions, public notice is given of the proposed projects. Public comments are incorporated into the decision making process as the license applications are reviewed

▶ **No Nationalization of Projects**

All such projects established by the private sector will not be nationalized during the term of the license

▶ **Investments Allowed**

In order to provide flexibility in investment opportunities, HMG/N will allow investments comprising the following

- Sole venture of national or foreign investors
- Joint venture of national and/or foreign investors
- Joint venture of government and national and/or foreign investors

▶ **Repatriation of Foreign Exchange**

Liberal policies on foreign exchange repatriation of loan principal and interest on debt, the return on equity, and the sale of share equity. All repatriation is guaranteed at prevailing rates

▶ **Income Tax Incentives**

Tax holidays are given for up to 15 years on hydropower generation projects, to 10 years on transmission projects and to five years on distribution projects. Developers with operation and maintenance contracts receive a tax holiday for a period of five years. In addition, foreign lenders are exempt from tax on interest earned and equity investors are exempt from tax on dividends. All developers reinvesting in or upgrading their existing projects during the license period will receive a tax exemption on 50 percent of the amount of the reinvestment

▶ **Import Concessions**

For materials and equipment associated with the projects, only 1 percent customs duty will be assessed. Additionally, there is no import license fee nor any type of sales tax.

▶ **Royalty Payments**

Royalties for the first fifteen years of operation are levied at the rate of Nrs 100 per kW of installed generation capacity with an energy charge of 2 percent of the average tariff per kWh. After the fifteenth year, the royalties increase to Nrs 1000 per kW of installed capacity and 10 percent of the average energy charge per kWh.

### 3.4 Comparison of Project Agreements

The terms and conditions of two documents from the Asian region and intended for privately financed independent power projects were reviewed and compared to the terms and conditions of contemplated power sales agreements currently being examined or processed by EDC. These documents are as follows:

- ▶ Draft Standardized Implementation Agreement - August 1994 - Water and Power Development Authority - Pakistan
- ▶ Applicable Legal/Regulatory Issues for IPPs in Thailand - Attachment F to the Request for Proposals for Power Purchases from Independent Power Producers - Electricity Generating Authority of Thailand - 1994 Solicitation

Comparison of selected items are as follows:

▶ **“Window” Policy**

Nepal has such a policy. Thailand does not - there appear to be a lot of individual permits that have to be obtained. Pakistan has a “one window” policy which is administered by the Private Power and Infrastructure Board.

▶ **Licensing Provisions**

**Pakistan** Not stated in implementation agreement but it is understood that licensing requirements exist.

**Thailand** The following documents have to be obtained:

- A construction permit from the provincial government
- A factory operation license from the Ministry of Industry
- A concession from the Ministry of Interior
- If the plant capacity is 200 kVA or more, an additional license is required from the Department of Energy Development and Promotion at the Ministry of Science, Technology and Environment.

**Nepal** A survey license will be issued within 30 days of application for a period of up to five years. Following this, a production license is required for a generating plant and another production license is required for any transmission line needed.

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► **Water Rights**

- Pakistan Not stated in the implementation agreement but arrangements are likely to be in effect
- Thailand Not really stated in the 1994 solicitation document what the position of a hydroelectric project would be. For a water supply, the solicitation document states that the IPP may need to negotiate a water agreement with the owner of the water. Such negotiation may be with the Provincial Waterworks Authority or the Industrial Estate Authority of Thailand. Both agencies are empowered to enter into such an agreement under the Provincial Waterworks Act and the Industrial Estate Authority of Thailand Act. Frequently, however, such agencies are reluctant to commit contractually to provide water to an IPP or any party on a long term basis.
- Nepal License provisions give the licensee exclusive rights for the use of water for the project. Such water rights are specified as to the location and specific quantity required for the licensed project.

► **Environmental Requirements**

- Pakistan Not stated in the implementation agreement, but it is understood that developers of all power projects must prepare for submission to the government an environmental and social soundness assessment. The assessment requires a full description of the project and the affected environment, the collection of at least one year of baseline data covering meteorological information and water quality data, and evaluations of socioeconomic impact, resettlement of local population, hazardous waste, and material handling. The assessment also has to include a mitigation and resettlement plan, if needed, showing costs, duration, and other factors. Finally, an ongoing monitoring plan must be drafted for continued environmental compliance.
- Thailand The bulk of the laws and regulations concerning environmental matters are contained in the Enhancement and Conservation of National Environmental Quality act and the Ministerial Regulations issued under the Act. A complete review of these laws and regulations would be necessary before the preliminary plant design and specifications are determined.
- Nepal All projects must comply with the existing rules and regulations regarding environmental impact mitigation and must be developed without substantial adverse environmental impact.

► **Nationalization**

- Pakistan Not clear from draft implementation agreement but it is understood suitable guarantees are in place.
- Thailand Certain guarantees and protection from nationalization of assets, state competition, state monopolistic policies, and price controls.
- Nepal All such projects established by the private sector will not be nationalized during the term of the license.

► **Investments Allowed**

Pakistan Not stated in the draft implementation agreement

Thailand Utilities as an area of special encouragement Criteria for Joint Ventures available

Nepal In order to provide flexibility in investment opportunities, HMG/N will allow investments comprising the following

- Sole venture of national or foreign investors
- Joint venture of national and/or foreign investors
- Joint venture of government and national and/or foreign investors

► **Repatriation of Foreign Exchange**

Liberal policies on foreign exchange repatriation of loan principal and interest on debt, the return on equity, and the sale of share equity are pursued in Pakistan, Thailand and Nepal All repatriation is guaranteed at prevailing rates

► **Income Tax Incentives**

Pakistan Project company not subject to tax on income from the sale of electricity During the term of the power purchase agreement, a non-resident lender will not be subject to taxation on income from interest, mark-up, fees, or other payments arising from loans extended to the project company for purposes of the design and construction of the complex and the permanent financing provided to the project company for the project pursuant to the financing documents Foreign investors will be governed by the bilateral tax treaties with their respective countries If there is no such treaty, the foreign will be taxed an accordance with the Laws of Pakistan

Thailand Income tax exemptions for three to five years (normal situation) or eight years (exceptional situation)

Nepal Tax holidays are given for up to 15 years on hydropower generation projects, to 10 years on transmission projects and to five years on distribution projects Developers with operation and maintenance contracts receive a tax holiday for a period of five years In addition, foreign lenders are exempt from tax on interest earned and equity investors are exempt from tax on dividends All developers reinvesting in or upgrading their existing projects during the license period will receive a tax exemption on 50 percent of the amount of the reinvestment

► **Import Concessions**

Pakistan Excise duty is not applicable to sales of electricity or loans from foreign lenders Sales tax is not applicable to the sale of electricity and there are no octroi charges on the supply of electricity No customs duties will apply prior to the commercial operations date

Thailand Import duties are exempted or reduced on equipment and machinery used in the construction and operation of the project

Nepal For materials and equipment associated with the projects, only 1 percent customs duty will be assessed Additionally, there is no import license fee nor any type of sales tax

▶ **Royalty Payments**

Pakistan No reference in the draft implementation agreement

Thailand No reference in the 1994 solicitation document

Nepal Royalties for the first fifteen years of operation are levied at the rate of Nrs 100 per kW of installed generation capacity with an energy charge of 2 percent of the average tariff per kWh  
After the fifteenth year, the royalties increase to Nrs 1000 per kW of installed capacity and 10 percent of the average energy charge per kWh

## 4 Power Purchase Agreements

### 4.1 Purpose and Background

The power purchase agreement establishes the power sales obligations between the project company and the power purchaser and identifies the type of transaction (e.g., BOO or BOOT). Although the terms and conditions are often complex, the power purchase agreement commits the producer to specified conditions (e.g., maximum output, total electrical generation in kilowatt hours) over a defined period and commits the purchaser to compensate the producer by an established amount and tariff rates whenever the facility is available and capable of generating power.

Because the power purchase agreement provides the only revenue stream for repayment of debt and return to investors, it is important to the lender. Consequently, the terms and conditions of this agreement will be heavily influenced by the lender's desire to enhance potential revenue and minimize risk. In this case, the risk to be avoided is the reduction or termination of the revenue stream, regardless of the cause. The greater the real or perceived risk to the project company, the higher the price the purchaser can expect to pay.

### 4.2 Comparison of Power Purchase Agreements

The terms and conditions of power purchase agreements from the Asian region and intended for privately financed independent power projects were reviewed and compared to the terms and conditions of contemplated power sales agreements currently being examined or processed by EDC. These agreements are as follows:

- ▶ Draft Standardized Power Purchase Agreement - June 1994 - Water and Power Development Authority - Pakistan
- ▶ Model Power Purchase Agreement - Electricity Generating Authority of Thailand - Appendix B to the Request for Proposals for Power Purchases from Independent Power Producers - 1994 Solicitation

Comparisons of selected items are as follows:

#### 4.2.1 Tariffs

The above-referenced Pakistan and Thailand power purchase agreements appear to be for large thermal plants and the agreements are fairly lengthy and complex. Both employ one-part tariffs. All the agreements, including that reviewed for Nepal, have provision for escalation.

#### 4.2.2 Force Majeure

Pakistan, Thailand, and Nepal agreements have substantial clauses defining Force Majeure in terms of events beyond the reasonable control of the parties and making provision for delays, payments, and notifications.

### 4 2 3 Dispute Resolution

Pakistan	Resolution by Parties Mediation by Expert Arbitration Rules of Procedure for Arbitration Proceedings of the International Center for the Settlement of Investment Disputes (ICSID) Location of Arbitration Islamabad, Pakistan. However, if Project Company pays, then they have the right to hold the arbitration in London, England
Thailand	Resolution by Parties Resolution by Expert Arbitration Arbitration Rules of the International Chamber of Commerce Location of Arbitration - Thailand
Nepal	Dispute resolution by mutual agreement Arbitration in accordance with the rules of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration will be conducted in Kathmandu, Nepal

### 4 2 4 Term

Pakistan	30 years - can be renewed for a further five years
Thailand	Not given - provision for extension on mutual terms
Nepal	25 years - may be extended by mutual agreement

### 4 2 5 Events of Default

Each of the power purchase contracts reviewed contains event of default clauses specific to the individual projects

### 4 2 6 Changes in Law

The Pakistan, Thailand and Nepal contracts have provision for changes in law All have provisions for determining and putting into effect any adjustments necessary

### 4 2 7 Governing Law

Pakistan	Laws of the Islamic Republic of Pakistan
Thailand	Laws of Thailand
Nepal	Laws of Nepal

## 4 2 8 Language

Pakistan English

Thailand The agreement is executed in English and all modifications, amendments and waivers of any provisions of the agreement will be in English. All other documents, notices and communication in connection with the agreement will be in the Thai language.

Nepal English

## 4 2 9 Liquidated Damages

Both the Pakistan and Thailand agreements have provision for liquidated damages. However, this does not appear to be the case in the Nepal agreement.

## 4 3 Terms and Conditions

A typical table of contents of a power purchase agreement is given in Appendix C. A discussion of the various agreement terms and conditions is as follows.

### 4 3 1 Preamble

(a) **Article 1 - Definitions and Interpretations**

Provides the meaning of significant words or word groups used in a document. Definitions should be as unqualified, unambiguous, and precise as possible - any qualifications should be dealt with in the body of the power purchase agreement. For example, "Change in Law" may be defined too widely to include not only any amendment in a law but also virtually any action or order by government. Such a wide definition may allow the developer to claim monetary compensation for an infinite number of eventualities which the purchaser has to control and which will be quite unpredictable. The objective of the purchaser should be to narrow this down by trying to specify those charges which may have a direct bearing on the project company. Similarly, the developer may try to hedge his risks through the "definition" route by putting in a number of qualifications in definitions of terms like "capital cost," "construction period," and "available capacity."

(b) **Article 2 - Sale and Purchase of Energy and Capacity**

Contains statements a project company agrees to sell power to a purchaser per terms and conditions of the agreement, and that purchaser agrees to the terms and conditions. The project company is obligated to provide a number of documents that verify and certify characteristics of the generating facility. The producer will make available and sell to the purchaser, and the purchaser will purchase from the producer for an agreed-on compensation a specified maximum dependable capacity and an associated energy output of the plant after its commercial operation date.

(c) **Article 3 - Conditions Precedent**

Conditions precedent have to be satisfied before the respective obligations of the parties become operational. The obligations of the project company include provision of

- All permits and approvals (Environmental, land use and siting and others)
- Other contracts (Fuel, land purchase/lease, engineering, procurement, and construction, operation and maintenance, thermal sales and others)
- Development and financing (Time frame and schedule for completion)
- Various legal opinions including one relating to enforceability of this agreement

The obligations of the purchaser include various legal opinions such as purchasers' ability to enter into and perform its obligations under the agreement. The obligations of both the purchaser and the project company should be tied to specific end dates with appropriate actions delineated if these dates are not met.

**(d) Article 4 - Term and Termination**

Identifies the effective start and end date of the agreement, conditions under which it can be extended and/or terminated, and the process and remedies for termination. The term of the agreement is generally stated in years from the date of commercial operation of the plant. The agreement should be in effect at least as long as there is outstanding debt. The purchaser should carefully examine if there is any particular economic benefit in agreeing to a longer term than this. Disposition of project facilities at the termination of the agreement should be specified. This may include physical transfer or purchase of the facility, continuation of the agreement, or liquidation of salvageable assets. Provisions should be made for events of default. Examples of default include

- Material breach of obligations not cured within a reasonable time
- Insolvency of project company
- Failure to produce a certain minimum amount of energy or achieve a certain availability of plant over an extended period of time

For any event of default in the power purchase agreement, a "cure" period should be established. Only if no cure is effected should penalties be applied. As the power purchase agreement is meant to be worked for its entire term and notice of termination should be resorted to only in most extraordinary circumstances, this provision should have equitable and symmetrical terms for

- Kind of default
- Mechanism for notice (including notice period)
- Cure
- Payment obligations
- Good faith discussions
- Other items

The termination provisions will vary depending on the stage at which it takes place - for example, whether during the construction stage, or while in operation, or whether before or after the debt has been paid off. The termination provision will also usually require the purchaser to buy out the plant at a defined price according to a given formula in the power purchase agreement.

**(e) Article 5 - Pre-operation Period**

Contains the responsibilities of the project company and purchaser during the permit, construction, testing, and start-up period. Terminates at commercial operation date.

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- **Development Stage** The scheduled milestones and deadlines should be given, including completion of licensing and closing of construction financing. Purchaser may have obligations to assist with authorizations but should be careful not to assume any contractual obligations.
  - **Construction Stage** The power purchase agreement should provide a contractual obligation on the project company that the power station enters into commercial service by a specified date. Also, the power station has to meet specified technical parameters, including the ability to deliver power by a given date. Project company has to assume the design risk and suffer penalties if requirements are not met due to deficiencies of design. If through project company's fault, the plant performs below the guaranteed performance, then project company should suffer penalties on their electric rate until the correct performance is achieved. Therefore, the purchaser should have the right to monitor the construction stage, including
    - Reasonable access of purchaser's representative to the construction site
    - Periodical reports on the progress of construction
  - **Commissioning and Entry into Commercial Service** The power purchase agreement should provide significant penalties for
    - Delayed entry into commercial service
    - Shortfall in the nameplate capacity
- (f) **Article 6 - Control and Operation of Facilities**  
Describes how the facility will be operated and maintained, how power will be dispatched, and the types of documents and records to be maintained. The power purchase agreement should state in detail the project company's duty to operate and maintain the power station in accordance with good industry practice and purchaser's grid requirements. The scheduled maintenance should be clearly stated. A purchaser's right of access should be clearly stated.
- (g) **Article 7 - Testing and Capacity Rating**  
Establishes a program for determining the maximum reliable electrical power generating capabilities of the facility under various conditions. If test results are acceptable, the facility will be placed in operation.
- (h) **Article 8 - Interconnection**  
Describes the interconnection point at which responsibility transfers from the project company to the purchaser. Details the responsibilities of the project company and the purchaser in the planning, design, construction, commissioning, and operation and maintenance of the interconnection facilities.
- (i) **Article 9 - Metering**  
Describes how power generation will be measured, metering responsibilities, and other interface responsibilities between the project company and the purchaser. The responsibilities of the project company and purchaser for installation and operation and maintenance of communications equipment, as well as the measurement of energy output and dependable capacity using the plant metering system, should be stated. Typically, the power purchaser will control the measurement of the energy output and dependable capacity.

- (j) **Article 10 - Rates and Charges**  
Describes the price of power to be paid by the purchaser to the project company for the duration of the agreement, which is stated on a unit rate basis (such as price/kWh) to include both energy and capacity charges or broken down into its components. Pricing formulas are often complex and comprise a number of components that reflect fixed and variable costs of power generation, including debt service, fuel cost, and operating and maintenance costs. These components in turn are based on actual costs, cost indices, or other methods.
- (k) **Article 11 - Fuel Price Provisions**  
Plant fuel should be described in detail, including constituent make-up, heat content, limits on contaminants, supply pressure (if gas) and other qualitative measurements. Fuel can be a pass-through cost from supplier to purchaser or, depending on the risk the participants are willing to accept, and be tied to a price index. As fuel is the major operational cost for most technology, treatment and recovery of fuel cost is critical to power price.
- (l) **Article 12 - Billing and Payment Procedure**  
Procedures should be given here for meter reading dates, time periods for preparation and delivery of bills, time periods for rendering payment, interest rate for late payment, and procedures for disputed payments.
- (m) **Article 13 - Changes in Law**  
Provides for protection of the project company should the law change to adversely affect the cost of construction or operation.
- (n) **Article 14 - Force Majeure**  
Defines what events constitute a force majeure such as acts of God, war, riots, nonculpable labor strikes, and their consequences to each of the parties during the term of the agreement. Force majeure events should be clearly defined and should not be too wide. They should cover only exceptional circumstances and not normal business risks. Insurable events should be kept out of force majeure. The manner of intimating to the other party about a force majeure situation, the remedy, etc. should be spelt out in detail in the power purchase agreement.
- (o) **Article 15 - Representations, Warranties and Covenants**  
Conveys agreement of the project company to operate the plant as designed within the laws and regulations of the territory. Certifies that the project company is a valid legal entity, will use acceptable business practices, and provide information (as mutually agreed upon) to the power purchaser.
- (p) **Article 16 - Liability, Noncompliance, and Guarantees**  
Includes indemnification obligations between project company and purchaser, and form and limits of facility completion guarantee. Specific obligations of one party to the other should there be plant equipment failure, property damage, or failure to provide electrical capacity as specified may be provided.

- (q) **Article 17 - Insurance**  
Delineates the type and limits of insurance to be obtained by the project company, including business interruption insurance
- (r) **Article 18 - Governing Law**  
Identifies under which law the agreement will be governed. Usually, this is the law of the host country
- (s) **Article 19 - Dispute Resolution**  
This article defines the process by which the project company and the purchaser can settle disputes about the interpretation of agreements and performance of various commitments. This process may include a mutually appointed operating committee, discussions, referral to an expert and arbitration in a predesignated location. With regard to governing laws, it should be appreciated that it is possible to have one substantive law governing the power purchase agreement and a different law governing the procedures for arbitration. The governing law should be the law of country. The developers generally insist on arbitration in accordance with one of the recognized international conventions on arbitration procedures and often require the arbitration to be outside of the host country and under the law of the place of the arbitration. The common international procedures used in such arbitration are the following:
- UNCITRAL Rules - United Nations Commission on International Trade Law
  - ICC Rules, Paris - International Chamber of Commerce
  - ICSID Rules - International Centre for Settlement of Investment Disputes
- There are some common misconceptions about these conventions. It is important to realize that accepting one of these for arbitration does not amount to compromising a country's sovereignty. These simply lay down procedural details like notice period, number of arbitrators', appointment of arbitrators', statement of defense, evidence and hearings, deposit and apportionment of costs, etc. It is not obligatory that arbitration has to be outside the host country in case one of these international rules of arbitration is accepted. It is possible to have arbitration within the country with these rules. Arbitration should be a last resort. Prior to that, the power purchase agreement should provide detailed arrangements for resolution of disputes through mutual discussions at appropriate levels, conciliation, with the help of experts, etc.
- (t) **Article 20 - Notices**  
Provides for method, language, process, and distribution of notices among parties
- (u) **Article 21 - Miscellaneous Provisions**  
Includes a variety of other general terms and conditions considered necessary but not warranting a separate section

## 5 Risks

### 5.1 Risk Categories

The development of power projects on a project finance basis involves risk for all the participants, including the project sponsor or developer, equity investors, lenders, power purchaser, government agencies, construction contractors and equipment suppliers and the operation and maintenance contractor. The ability of the parties to agree on how risks will be shared is often the key to a successful project. However, when developers are unable to provide guarantees adequate to satisfy lenders, lenders will seek government guarantees. Risks fall into five categories as follows:

- ▶ Commercial Risks
- ▶ Political or Country Risks
- ▶ Financial Risks
- ▶ Legal Risks
- ▶ Force Majeure

Each of these risks is discussed below followed by a brief note on government guarantees.

This section should be read in conjunction with the report prepared by the Financial Contract Specialist which provides a financial model for the project finance approach and covers the financial analysis, risk analysis and risk mitigation of projects. The success of the financing process is largely related to the management of risk and the ability to negotiate an equitable sharing of the various risks. The rate of return of the project company is one of the factors involved. It may be that a higher rate of return for the project company may be worth the additional risk they may be prepared to take. This section defines the risks. The Financial Contract Specialist is providing a mechanism for how risk can be shared. This two-way approach is to aid in the understanding of risk and the quantification of risk for the development of a privately financed power project.

### 5.2 Commercial Risks

The main commercial and operational risks are construction/completion risk, inflation risk, technology risk, operating risk, and regulatory risk. For example, a delay in project completion may require the power purchaser to obtain power from another source, possibly at a higher cost. Delays in completion or increases in construction costs affect the developer and the lenders. During the operating phase, the failures are manifested through poor technical and financial performance.

These risks are mitigated by arranging a well-thought-out project structure with reliable and experienced construction companies and operations and maintenance contractors. It is essential that construction and operation and maintenance contractors possess the technical, managerial, and financial capabilities to assure completion of the project and its continuing operation. This may be accomplished by prequalifying contractors and carefully reviewing the contractors' past experiences and commitment on similar projects. Liquidated damages provisions in the construction and operation contracts are a second line of defense. Further mitigation is provided by securing completion guarantees from contractors. The project company can minimize risks

through the quality of its own management and technical resources and through its ability to manage the contractors and the project's financial and commercial agreements

### **5 3 Political and Country Risks**

Political risks are those associated with changes of government, executive actions, laws and policies which adversely affect a project's operations, its owners or its lenders. Political risks are sometimes insurable by multilateral investment/financing agencies. Ultimately, through whatever means, it is the host government and its electric power utilities that are best able to mitigate political risk. Therefore either directly or indirectly, such risk will generally be allocated to and borne by the host government.

Major political risks are the potential for nationalization of project assets, enforceability of contracts, and changes in political support and laws. These are discussed further below.

#### **5 3 1 Potential for Nationalization of Project Assets**

Although nationalization and expropriation of property may not currently be a problem in the country concerned, and although the assets and property of foreign persons may currently be protected by the constitution of the country, developers and providers of capital should be aware of the possibility of such government action, however unlikely it might seem to be.

Host governments of developing countries and their electric utilities should be prepared to provide sufficient comfort to the project sponsors and lenders that nationalization or expropriation will not occur, or if they do that the project sponsors and lenders will be made whole with respect to their investment and expected return. In addition to such host government support, project sponsors may be able to rely on the special country insurance, to the extent it is available for the country in question, made available by multilateral investment agencies. However, such insurance is difficult to obtain, and, if available at all, is very expensive. In most cases, the cost involved is passed on to the purchaser.

#### **5 3 2 Enforceability of Contracts**

This is fundamental. The enforceability of written contracts is crucial to successful project finance, since contractual terms are the basis for the financing of the project. Only through mutual assurance of enforceability can the parties realize the allocation of risks and benefits agreed to at inception of the project.

Since national or local governments, or government controlled entities such as power utilities often are parties to project agreements, additional issues are raised. These issues include the extent of sovereign immunity, the availability of unbiased forums for dispute resolution, and whether performance may be subject to budget or other regulatory and political procedures.

In the United States and other industrialized nations with recorded histories of governmental enforcement of private and public contracts, as well as an established, independent and stable judiciary, the question of enforceability of contracts is normally not a significant issue. It is usually addressed by the receipt of "legal opinions" of well-respected law firms indicating on what basis the parties will be able to enforce their contracts.

In countries which do not have a history of enforcement of contracts and independent judiciaries, the host government will need to be prepared to provide the comfort and support (as may be required by the international lending and project finance community) that all contracts made and performed in the host country will be observed and enforced. The host government's attorney and local private attorneys will also need to provide legal opinions on enforceability. In some countries, special statutes have been passed to ensure contract enforceability.

### **5 3 3 Changes in Political Support and Laws**

Generally, investors in project financed power plants are unwilling to assume the risk that a change in political priorities or control may result in a change in law or policy that will in turn increase the projected cost of owning and operating the power plant or distributing and repatriating profits. Project investors may also be concerned that short of outright expropriation, more gradual changes in political support or withdrawal of cooperation by government-owned utilities could over time effectively undermine the legal and regulatory framework upon which projects were built (a so-called, "creeping expropriation"). Since the cost of and financing for a 30-year power plant is fixed when construction commences, any change on policy or law thereafter which reduces the investors' projected returns will not only adversely affect the investors. It will also limit the ability of the host government to establish, maintain and expand a privately financed electric power industry. While some forms of political risk insurance, if available, may partially address these concerns, the host government should be willing to address and assume the risk of changes in policy and law which occur after the financing closes.

## **5 4 Financial Risks**

### **5 4 1 Currency Fluctuation**

In the United States or the United Kingdom, for example, currency fluctuation for independent power projects is not usually an issue since the funds to construct the power plants are provided in the same currency by which revenue payments will be made to the owners of the project.

This situation is unlikely to exist in most other nations since much of the equipment and construction cost will be denominated in currencies other than those of the host country. Insurance (including multilateral-sponsored insurance) is generally not available for the currency fluctuation risk. Therefore, the project must either fix currency fluctuation risk through often prohibitively expensive (and sometimes unavailable) financial market instruments or obtain the right to pass-through the cost of currency fluctuation. In any event, lenders will not accept currency fluctuation risk and most developers will insist on limiting their liability for any such risk. Thus, although this risk is one of the more commercial and market related risks, it remains a risk for which the host government should be responsible. The utility would have had to incur such risk anyway if it had purchased the quality overseas equipment offered by the developer and financed it in the same manner.

### **5 4 2 Availability of Foreign Exchange**

Unless a nation has substantial exports to the nation from which most of the goods and services to construct the project are to be sources, a significant issue will be whether the host country will have sufficient reserves of the source nation's currency to enable the project investors to be paid in the

currency agreed to. Some of the risk associated with foreign exchange can be mitigated by sourcing materials and goods for the project in the host nation. Ordinarily, however, only a central bank type of assurance on this issue will satisfy project participants that the debt will be repaid in the currencies agreed to and that profits can be repatriated.

#### **5 4 3 Local Inflation**

As the rate of inflation in industrializing nations often fluctuates greatly, more attention is paid to this risk than in industrialized nations where inflation is more predictable. The purchasing electric utility should be prepared to accept the cost of local inflation and be prepared to work with the developer to find ways of limiting this risk.

#### **5 4 4 Credit Worthiness of Local Utilities**

In industrialized nations, lenders who provide financing for power plants rely heavily on the creditworthiness or "investment grade rating" of the utility which has agreed to purchase the power plant's output. The creditworthiness is determined by reviewing the financial performance reports of the utility as reported in standard accounting reports, audited by professional and recognized accounting firms.

For governments and electric utilities which have not had much transactional experience with persons other than another government agency, establishing such accounts and records may take years before sufficient credit worthiness could be established and ratings determined.

Therefore, many of these local governments and utilities will have to provide either a special security for their payment obligations with respect to the power project (for example, security interests in the receivables of retail electricity customers, irrevocable letters of credit, etc.) or a form of support from the central government.

For cash flow risks, irrevocable letters of credit should be provided to address the question of cash flow liquidity.

#### **5 4 5 Impact of Taxes and Fees on Costs of Construction and Repatriated Funds**

An important determinant of the economic viability of the project is the impact of taxes and other government fees on project costs and repatriated funds. The tax implications of cross-border projects and the availability of exemptions require careful review and discussion.

### **5 5 Legal Risks**

Just as in the case of political risks related to enforceability of contracts, the success of project finance depends on the adequacy of the legal system to assure enforceability of the various project contracts among the parties to the agreements themselves. Consequently, the legal risks, those related to the project contracts as well as the legal structure and regulatory environment under which the power plant will be developed, are paramount.

### 5 5 1 Legal Framework

A favorable legal framework and environment will provide, among other provisions, at least the following

- Legal precedent or statutes which clearly and unequivocally provide for the enforcement of all written contracts, regardless of the nationality of the parties
- A regulatory framework, including requirements related to reliable, long-term demand forecasts and market based pricing of electricity, which encourages the retail utilities to develop into well capitalized, professionally organized, accountable and largely self sufficient utilities
- A regulatory framework that allows sufficient latitude for (i) the market pricing of electricity generated by the independent power plant and (ii) limited regulation of the power plant's operations (other than to ensure public safety and reliable service)
- A central and local government framework that allows the developer to (i) determine in advance the environmental, construction and other permits and governmental authorizations required to develop the project and (ii) know that when the developer meets such objective requirements the permit or authorization will be provided in the ordinary course
- A relatively free market environment in which the developer and contractor can negotiate relations with labor
- An organized and proven system for establishing security interests in real and personal property
- Little to no regulation of the ownership of the entity which owns the power plant, or of the distribution and repatriation of profits
- An independent, properly staffed and honored judicial system which bases its decisions on precedent and established rules of procedure

An unfavorable legal framework or regulatory environment is probably in place if any of the following exists

- Extensive regulation of the independent power plant and its owners as if the plant were a retail monopoly like most utilities
- A legal framework that requires the independent power plant to bear substantially greater risk than the state owned utility would incur if it were to build the new plant
- Laws restricting the repatriation of profits or nationality of those having an interest in a power plant
- Legal precedents and government action irrationally setting aside established legal protections and benefits, including security interests
- Laws, including tax policy, which discriminate in any substantial way against the newly created independent power industry or private firms which are owned by foreign nationals

### 5 5 2 Dispute Resolution Procedures

In countries which are just beginning to permit foreign private investment or which do not have an established and historically reliable judiciary, attention to dispute resolution procedures and forums is very important. Ultimately, recourse to the host nation's courts may be acceptable or even preferred, but in most newly industrializing nations arbitration, in accordance with some internationally recognized and established standards and rules, will be the preferred means of dispute resolution. Such arbitrations usually are required to take place in some neutral location even if the host nation's laws are controlling.

In addition, the developer and the lender will require comfort that the host government will not utilize the shield of sovereign immunity to avoid judgements and arbitration awards, such comfort provisions might, for example, permit the successful party the right to attach and collect assets of the host government held outside the host country

### **5 5 3 Limited Liability Concepts**

One of the ways the developer of a project financed power plant ensures that its liability for development, construction, and operation of the power plant will be at least structurally limited is to rely on the limited pass-through liability of subsidiary corporations and partnerships

In other words, once the developer has capitalized the project company, it must be assured that in the unlikely event that the project company's liabilities ever exceed its assets (or even if just the cash flow turns out to be insufficient at one particular moment) that the developer's/owner's of the power plant will not have residual responsibility to assume and satisfy such liabilities. Most nations provide for such limited liability corporations and partnerships. Local legal opinions will be required to warrant the limited liability status of such project companies

### **5 5 4 U S and Other Foreign Laws Applicable to the Developers/Owners**

Host nations and their utilities also need to be prepared to understand and respect the U S laws and regulations which U S corporations may be subject to in their activities abroad. Many of the corporations developing power plants around the world are regulated with respect to some of their operations. Such developers will strive to structure their development and ownership of an overseas power plant in such a way so as to avoid or minimize home country regulation or other adverse accounting or reporting requirements

In addition, because many of the developers are publicly owned corporations, they are subject to substantial public disclosure requirements about their activities and the activities of their subsidiaries. Corporations are also subject to required internal procedures and approvals of their boards of directors and shareholders pursuant to the corporation's articles of association and bylaw. Those requirements generally are not a barrier to Nepal ventures by U S companies

Finally, all U S developers are restricted by law, and most are restricted by their own corporate ethical policies, from making special payments or gifts to any government official (including officers of government owned corporations), in order to obtain special treatment. Some developers may ask the utility they deal with to assist them in ensuring that such payments are never made by any of their employees, partners, or agents

## **5 6 Force Majeure**

Force majeure events should be clearly defined and should not be too wide. They should cover only exceptional circumstances and not normal business risks

## 5.7 Government Guarantees

Government guarantees are often needed to assure the project that certain events within the control of the government will or will not occur. If such assurance is breached, project companies and investors will be compensated or relieved from the consequences of these events. Most of the events would fall within one of the risk categories discussed above.

Comprehensive coverage of all project risks through a blanket government guarantee is not generally feasible. The actual requirement for government guarantees will depend on the characteristics of the project and the extent of the risks. The ability of the sponsors to structure the various agreements so that those risks are mitigated will minimize the need for government guarantees. Normally, government guarantees are a product of extensive negotiation and compromise.

## 6 Documentation For Financial Closing

### 6.1 Project Closing Requirements

Financial closing takes place when all agreements have been executed and financing arranged so that disbursements from the proceeds of the financing can take place. In practice, execution of most agreements occurs at the time of financial closing.

For information, a typical project closing list is given in Appendix D and a table of contents for a sample construction loan agreement is given in Appendix E. As part of satisfying themselves that they are comfortable with the arrangements, lenders will perform various investigative studies or due diligence as this is often referred to. A typical lenders due diligence checklist is set out in Appendix F and a typical scope of work for an independent engineer assisting in the due diligence process is listed in Appendix G.

### 6.2 Typical Financing Documents

The documents typically required for a typical project finance transaction are described below. However, it should be noted that each transaction may be different, depending on, for example, the number and type of participants (multinational lenders, commercial banks, etc.) and the complexity of the deal. Thus, the documents required may vary from those described below. The documents are also listed in Appendix D for general reference. The list does reference some, but not necessarily all, of the documents that a private developer will be required to obtain in Nepal.

The documents are discussed below under the following headings:

- ▶ Transaction Documents
- ▶ Project Documents
- ▶ Insurance Contracts and Certificates
- ▶ Security Documents
- ▶ Corporate Documents
- ▶ Approvals, Licenses and Permits
- ▶ Legal Opinions
- ▶ Miscellaneous Closing Documents

#### 6.2.1 Transaction Documents

##### (a) Credit/Loan Agreement

The principal credit agreement usually takes the form of a construction and term loan agreement which provides for the making of construction loans during the period in which the project is being constructed (Construction Loan Note), and long-term loan on the date on which the project commences operation (Term Loan Note).

Some other variations include a note Purchase Agreement which is employed by insurance companies or investment banks and which provides for the sale of notes by the borrower (project company) to finance construction, Letter of Credit and Reimbursement Agreement which is employed when the lender, rather than making loans, posts a letter of credit supporting the issuance of taxable or tax-exempt bonds the proceeds of which are used to build the project, and

Participation Agreement which is employed when the project financing is done as a leveraged lease financing

(b) **Subordinated Debt or Equity Contribution Agreements**

These provide for additional funds in the form of equity contributions or subordinated loans. The equity contribution may provide that it may be called upon only in limited circumstances (i.e., cost overrun) and for a limited amount of money.

(c) **Lender Fee Letter**

This sets out the terms and conditions under which the loan agreement will be negotiated between the lender and the borrower. These terms and conditions include allocation of responsibilities between the parties for the costs involved, including those pertinent to the independent engineer, title insurance specialist, insurance consultant and other entities involved in the due diligence investigations.

## 6.2.2 Project Documents

(a) **Project Agreement**

(b) **Power Purchase Agreement**

- Interconnection Agreement
- Transmission Agreement
- Escrow Agreement/Letter of Credit

The agreement pursuant to which the power purchaser agrees to buy power from the project. This is the most important contract because it is the principal source of the revenues for the project.

(c) **Construction Agreement**

- Payment Bonds
- Performance Bonds

For example, a turnkey construction contract - a contract pursuant to which contractor agrees to build the project for a specified, by a specified date, and in compliance with specified performance standards.

(d) **Operation and Maintenance Agreement**

The agreement pursuant to which the borrower hires another, usually more experienced entity to operate the project once construction is finished.

(e) **Deeds or Site Lease**

Land purchase contracts, ground leases, and various easements, provide the site on which the project is to be built.

### 6 2 3 Insurance

- (a) Political Risk Insurance
- (b) Commercial Insurance Contracts
- (c) Certifications

### 6 2 4 Security Documents

(a) **Mortgage/Deed of Trust**

Grants the lender a lien on borrower's real property (fee simple or ground lease) and fixtures Also on the appropriate agreements This is in effect an agreement whereby the project and its documentation are mortgaged to the lender until the long term debt is paid

(b) **Stock Pledge Agreement**

Provides for pledge of stock of borrower or if borrower is a partnership, a pledge of stock of the corporate general partner

(c) **Partnership Pledge Agreement**

Provides for pledge of limited and general partnership interests in the borrower if the borrower is a partnership

(d) **Uniform Commercial Code Financing Statements**

(e) **Security Agreement**

Provides for blanket security agreement on all assets of the borrower that constitute personal property, in particular, the borrower's contract rights, revenue streams, and deposit accounts

(f) **Consent and Agreement**

Agreement pursuant to which each of the parties to a contract with the borrower usually agrees

- That the borrower may grant a security interest in its contract to the lender
- To provide the lender with a notice of and an opportunity to cure a breach of such contract by the borrower
- To pay amounts owing under such contract directly to the lender

There is generally one consent and agreement for each of the project parties that is a party to a principal project contracts

(g) **Guarantee**

Provides for some form of limited guarantee of borrower's obligations to lender by a creditworthy entity A guaranty of this type may provide that it may be called upon in limited circumstances (i e , cost overrun) and for a limited amount of money

(h) **Collateral Agency Agreement**

Provides for appointment of a collateral agent and establishes mechanics for distributing revenues received by the lenders for application to borrower's obligations

(i) **Intercreditor Agreement**

Sets forth agreements among lenders to the borrower as to priority of lender's claims, control of collateral, etc

**6 2 5 Corporate Documents**

Following is a representative list of corporate documents

- Certified Articles of Incorporation
- Certified By-Laws
- Certified Corporate Resolutions
- Good Standing and Tax Certificate

**6 2 6 Approvals, Licenses and Permits**

Following is a representative list of approvals, licences, and permits

- Project License is required pursuant to the Electricity Act, 2049, and the Electricity Rules, 2050
- All other approvals as per the Electricity Act, 2049, and the Electricity Rules, 2050, and all other relevant Laws applicable
- Land Use Compliance Permit
- Encroachment/Access Permits
- Environmental Review/Impact Compliance
- Permits for foreigners to invest in a Nepalese company and to borrow from Foreign Lenders
- A Permit to open and maintain bank accounts in foreign currency inside and outside Nepal
- An exemption from loan registration fees (including mortgage fees)
- A permit to mortgage assets or pledge shares to foreign lenders to this type of project

**6 2 7 Legal Opinions**

Following is a representative list of legal opinions

- Borrower's Special Counsel (corporate standing and procedures, enforceability, no conflict, no approvals)
- Borrower's Local Counsel (creation, perfection and priority of liens and security interests, environmental and land use compliance)
- Third Party Counsel (enforceability)
- Lender's Counsel

**6 2 8 Miscellaneous Closing Documents**

Following is a representative list of miscellaneous closing documents

- Independent Engineer's Report
- Independent Engineer's Certificate
- Insurance Policies or Certificates
- Insurance Adviser's Certificates
- Title Insurance Policies
- Environmental Consultant's Report
- Operating Budget
- Application for First Advance

- Borrower's Certificate re Representations/Defaults
- Borrower/Parent Financial Statements
- Uniform Commercial Code Search Reports

### **6 3 Representations and Warranties**

As a condition of the loan agreement, the bank or financial institution will require the borrower (the project company) to warrant that certain items regarding the project and the participants are correct and true. Such items include, but are not limited to, the organization and standing of the project company, validity of the loan documents, compliance with law, property titles, tax returns, litigation, undisclosed liabilities, and licenses.

Sample clauses for these representations and warranties are given in Appendix H.

## 7 Conclusions and Recommendations

### 7.1 Conclusions

#### 7.1.1 Introduction

The ultimate goal on any private power project is to have the project operating well, having been completed on time and within budget, and generating expected revenues. Before construction can get under way, however, all financing must be available so that the contractor can be mobilized and capital expenditures can begin. This happens at financial close - the ultimate financial goal in the development of a private power project.

This report has presented an overview of four major items that contribute to the documentation for financial close - the project agreement, the power purchase agreement, risk, and the financial closing documentation. These items are all dependent on each other.

#### 7.1.2 General Conclusion

The tables of content of project agreements and power purchase agreements contain items such as definitions, term and termination, force majeure, and others which are common to most projects. However, in studies into the possibility of standardizing terms and conditions for these agreements, the results of which are reported in this report, it was found that each project had different characteristics and requirements, and that standardization may not be feasible. The comments, formats and checklists given in this report should be carefully considered in the analysis of project agreements, power purchase agreements, and other financial closing documents.

#### 7.1.3 Project Agreements

Based on the review of project/implementation agreement documents from Pakistan and Thailand, together with similar documents currently being examined or processed by EDC, the following conclusions were drawn:

- Existing EDC project agreements have a similar structure and content as project agreements worldwide.
- Guarantees and incentives are being given in other countries as well as in Nepal to attract private developers and finance into the provision of generating plants.
- A typical list of contents for a project agreement is given in Appendix B. Article 4 of this list, entitled Obligations of Government, would include where applicable items in Section 3.2, Terms and Conditions, of this report under the heading Government/Purchaser Commitments. Article 5, Obligations of Project Company, would include where applicable items in Section 3.2, Terms and Conditions, under the heading Private Power Developer Commitments. Further information on the remaining articles may be obtained from that part of this report dealing with Power Purchase Agreements and in particular, Section 4.3, Terms and Conditions.
- There are considerable advantages to Nepal from the point of view of attracting private investment into the power sector in having a "One Window" Policy and one licensing authority. The effect of the forthcoming environmental legislation on the "One Window" policy will need careful evaluation.

## **7 1 4 Power Purchase Agreements**

The power purchase agreements currently being reviewed by EDC are similar in structure and content as power purchase agreements worldwide. A typical list of contents for a power purchase agreement is given in Appendix C.

## **7 2 Recommendations**

The legal and financial staff of EDC should be given suitable training, in seminars and by other means, in the documentation and other aspects of project finance discussed in this report. EDC should strengthen their legal expertise to be able to deal with foreign developers who are assisted by international law firms with great experience in the project finance approach. EDC should select a project to do as a solicitation and prepare a solicitation document with the aid of the presently available assistance with regard to financial, legal, and technical experience.

## 8 References

- 1 Cordukes, Peter A , ed 1994 "Submission and Evaluation of Proposals for Private Power Generation Projects in Developing Countries " World Bank discussion Paper No 250
- 2 Electricity Act, 2049 (1992)
- 3 Electricity Generating Authority of Thailand - Model Power Purchase Agreement - Appendix B to the Request for Proposals for Power Purchases from Independent Power Producers - 1994 Solicitation
- 4 Electricity Generating Authority of Thailand - Applicable Legal/Regulatory Issues for IPPs in Thailand - Attachment F to the Request for Proposals for Power Purchases from Independent Power Producers - 1994 Solicitation
- 5 Electricity Regulation, 2050 (1993)
- 6 Foreign Investment and One Window Policy (1992)
- 7 Hydropower Development Policy, 2049 (1992)
- 8 Industrial Policy (1992)
- 9 Water and Power Development Authority - Draft Standardized Power Purchase Agreement - June 1994 - Pakistan
- 10 Water and Power Development Authority - Draft Standardized Implementation Agreement - August 1994 - Pakistan
- 11 Water Resources Act, 2049 (1992)

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# Appendices

## Appendix A

### Glossary

*Note The definitions for the terms given below apply only in the context of this report These definitions by no means should be used or construed as legal definitions*

**Acceleration** Process by which lender moves to collect immediate and full payment of the loan Usually occurs sometime after defaults have occurred

**Assignment** Lenders usually require the assignment of all major project documents as security for the loan

**Avoided Cost** Supply costs by a power utility which are avoided when any demand or supply option is substituted for an equivalent part of an available demand/supply plan Use of avoided cost to evaluate the value of demand management and non-utility generation is a worldwide practice, despite the controversy on underlying assumptions and methods of calculating avoided costs

**Backup Power** Reserve power for special circumstances, such as an emergency or system failure

**BOO/BOOT/BLT Schemes** Build-Own-Operate (BOO) and Build-Own-Operate-Transfer (BOOT) schemes are methods by which private sector participation in the power sector is encouraged Under these approaches, a project company under private ownership or a joint venture with a minority public participation, is set up to plan, finance under limited recourse, design, construct and operate power generation facilities In a BOOT arrangement, ownership of the facility is ultimately transferred to another entity after a specified period of operation A variant is the Build-Lease-Transfer- (BLT) scheme

**Buy-back Rate or Tariff** The tariff set by the power utility and approved by the regulator as necessary for purchase of power from an independent power producer This is generally for all or some of the power the independent power producer generates Buy-back rates can be fixed by government, seasonally adjusted for capacity and energy, or negotiated between a private power producer and the utility

**Change Orders** Requests to materially alter terms or participants of project documents, most typically referring to changes in the construction contract

**Collateral** Assets of the project and its owners (land, plant, bank accounts, partnership interests, contracts, etc ) pledged to the lender as security for the loan

**Commercial Risk** Generally, those risks under the control of the project owner This may include project development, construction of the plant within budget and on time efficient operation of the plant within budget, employment of qualified personnel, etc

**Conditions Precedent** Conditions which must be met to the lender's satisfaction prior to closing a loan, receiving subsequent fundings of the loan, or conversion to a long-term loan, etc (Such as delivery of a satisfactory engineer's report to the lender)

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**Construction Loan** Loan advanced prior to the conversion date, which is used for the planning, design, construction, start-up and initial operation of the project. The loan typically matures upon the earlier of (I) an event of default (ii) project completion, and (iii) a date certain

**Construction Financing** Project financing arranged to cover the construction phase of a project which is normally sold or taken out by equity and long term debt financing once a project is commissioned

**Conversion** Process by which terms and obligations of the construction loan are extinguished and replaced by the term loan upon project completion

**Counter Guarantee** A guarantee provided by a third party, such as a government, when the ability of the purchasing party (the power utility) to make payments on the services it is obligated to buy (power) is in question. This guarantee may be required by investors financing the project company to ensure that payments will be made, or to otherwise provide flexibility to lower risks and financing costs

**Covenants** Specific agreements, generally as to business practices, which are carefully negotiated between the borrower and lender and are effective throughout the term of the loan. Affirmative covenants describe actions which are required while negative covenants describe actions which are prohibited

**Coverage** Generally used as a measure of a project's or company's ability debt service. The debt service coverage is the ratio of cash operating margins (revenues less operating and other expenses) to debt service (principal plus interest) over some period of time. Higher coverages indicate a greater cushion or margin for error in the project's ability to make timely debt service payments

**Credit Facility Agreement** This may be an individual loan or co-financing agreement between the borrower and a number of lenders

**Credit Quality** The ability of a project or company to meet its obligations and sustain operations, particularly during periods of adverse economic and industry conditions. Factors to be considered include (among others) financial strength, reputation in the industry and in the business community, extent of competitive advantage, expected future performance, and terms of contracts with suppliers and purchasers

**Cross-Subsidies** The allocation of funds provided by one or more products or sectors of the economy to other products or sectors of the economy. Often, this process is not transparent. For example, high prices for industrial users of electricity used to provide subsidies to domestic consumers

**Date of Financial Closing** The date of signing of the financing documents. See **Financial Closure and Financing Documents**

**Debt** Finance in the form of interest bearing loans

**Debt Financing** The use of long term loans to finance a project and generally to take out the construction financing

**Debt Service** The periodic payment of principal and interest on loans, bonds, or fixed/floating-rate notes

**Default** Events and occurrences where the borrower, through some action or inaction, violates one or more covenants or conditions of the loan agreement

**Developer** See **Private Power Developer**

**Development Period** This includes the time it takes to complete all studies, conclude negotiations, and arrange the financing required to achieve financial closure. The starting date of this period varies depending on how the project is initiated (e.g., bidding process, issuance of a letter of intent). The ending date would be the financial closure.

**Dispatch** The process of drawing electricity by the utility from a range of available plants to meet demand. Normally, this is done on a merit-order basis, that is, the plant that is capable of producing electricity at the lowest cost is chosen first, followed by the next lowest, etc., so that the plants with the highest operating costs are only utilized to meet peak demand requirements.

**Drawdowns** Limited advances of funds under the loan, typically a construction, working capital, or development loan. Typically used in order to make payments directly to construction contractor or other project participants. A loan normally has conditions precedent to each drawdown to enable a lender to "suspend" further fundings thereby reducing losses in cases of failure.

**Easements** A right given to an individual or group to make limited use of another's real property.

**Equity** Finance generally provided upfront, the return on which is not fixed, but is calculated on the net profit after all debt payments, operation and maintenance expenses, royalties and other payments have been made.

**Equity Commitment** Commitment by borrower or other party to contribute a significant portion of junior capital to project capitalization. Commitment is normally made prior to start of construction with the contribution normally required to be advanced upon completion of the project, or may be seized upon an event of default.

**Equity Investment** That part of the project financing provided up front by the developer or other private investors from their own sources.

**Export Credit Agencies** Country-specific banks or credit agencies set up to facilitate trade. Generally such banks, also called Export-Import banks or EXIM banks, will arrange suppliers' credits for own-country suppliers, usually for mechanical and electrical equipment and sometimes for feasibility studies.

**Final Acceptance** An event which occurs when the construction is complete and all performance tests are passed (or waived).

**Financial Closure** The point when the legal documentation for all project agreements and financial commitments are executed. It is when all the conditions of the lenders and investors have been met, and financing disbursements can take place. Financial closure can be one time or in stages. Closure can be for construction financing alone, followed by closure of debt and equity financing after commissioning of the project.

**Financing Documents** The shareholder's agreements, joint venture agreements, loan agreements, notes, indentures, security agreements, and other documents relating to the construction financing and permanent financing (including refinancing) of the project or any part thereof.

**Force Majeure** Uncontrollable events, generally defined to include a range of occurrences, including natural events (e.g. lightning, floods) and political events (e.g., revolution, civil unrest) Whether these latter events are controlled by governments is often debated during negotiations

**Grace Period** Period of time during which borrower or other participant can be out of compliance with covenants or other contracts, and lender or others can take no action Usually given for serious offences to allow time to "work things out" Also, the periods of time under a loan agreement that principal amounts are not payable

**Guarantee** An agreement to satisfy obligations or make payments on debt on behalf of another party

**Home Country** The country in which a private power developer is registered

**Host Country** The country in which the private power project is taking place

**Independent Power Producers** Private sector power producers who have developed a thermal, hydroelectric, or other power plants to sell power The power is normally a grid sale to an existing power utility, but can also be sold directly to distributors or directly to large consumers depending on the provisions in the host country power regulations relating to wheeling and market entry

**Investment Grade** Indicates that the investment is of good quality in terms of the ability of the obligor to meet debt service obligations It is normally indicated by an assigned rating, for Standard and Poor, s, the designation is BBB

**Investors** Individuals, groups, or companies that invest cash in a private power development group, or project company

**Least Cost Planning** A planning method to determine the optimal sequence and timing of new plants to meet the future needs of the power system It is derived from expected demand, and the cost and operational characteristics of candidate plants, it is normally calculated using optimization software

**Legal Opinion** An opinion formally rendered by an attorney with substantial qualification and recognized expertise in the subject matter

**Lenders** Commercial banks or other lending institutions such as insurance companies that provide secured loans to investors, or other types of loans directly to the project company Lenders typically provide the initial construction financing and the subsequent long-term debt financing with rates that are based on risk and term

**Limited Recourse** Generally refers to limitations on lenders' ability to seek payment or other benefits from the equity parties It can also refer to limitations on a project entity's recourse to the host government for support in certain circumstances

**Limited Recourse Financing** See **Project Finance**

**Liquidated Damages** Payments required to remedy a default in performance under the project documents (i.e., power sales agreement, steam supply agreement, ground lease, construction contract, fuel supply agreement, etc.) Most typically found in the construction contract Two general types are delay damages and performance

**damages** Delay damages compensate for increased interest expenses and foregone revenues resulting from missing the completion date Performance damages replace foregone revenues resulting from a failure to meet targeted project performance

**Maturity** Point in time when an obligation is terminated The time at which a promissory note or loan becomes due

**Non-Recourse Financing** A lending arrangement under which repayment of a loan and recourse in the event of default relies on the project's cash-flow and not to its assets A form of financing where the lender cannot seek recourse on obligations outside of the entities and assets defined in credit and security agreements See also **Project Finance**

**Partial Guarantee** A guarantee offered by a special fund or financial institution on a portion of the total credit, or for a specific risk such as sovereign risk or force majeure up to a limit A partial guarantee would be offered to share and thereby lower the total project risk as perceived by lenders and equity investors to permit consideration of lower financing costs and extended maturities more attractive to developing countries

**Peak Power** The maximum non-instantaneous electric power in a specified period of time

**Performance Bonds** Guarantees purchased by the project developer for a fee that are issued by commercial banks or insurance companies to guarantee payments for the full and successful implementation of a contract according to pre-specified performance guidelines

**Plant Downtime** Time when the power plant is not producing power because of scheduled or forced outage or shutdown

**Political Risk** Generally, those risks under the control of the government This will vary depending on the circumstances and the perceptions of project participants They may include the performance of government-owned entities (including the purchasing utility), regulatory environment, issuance of critical permits (customs, environment), and foreign exchange convertibility

**Power Purchase Agreement** See **Project Documents**

**Private Power Developer** An individual, group, or local or international company that plans and develops power generation facilities on a private sector basis with the intention to own, operate, lease, and/or transfer the facility to another entity, normally a public utility, at a future point in time

**Private Risk Capital** The amount of private sector financing provided for a project that is not directly guaranteed by government This is divided by the total amount of financing to arrive at a percentage figure

**Production** The construction, operation, and maintenance of structures relating to the production of electricity

**Project Agreements** Optional project-specific agreements that are normally in addition to the power purchase agreement Project Agreements consolidate in one document the government assurances and guarantees to private power developers required for successful project development and allocation of risk In high risk countries and/or the less detailed or less clearly defined the regulatory framework, the greater the need for a Project Agreement

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as an additional element in the security package the developer would take to the potential equity partners and debt lenders

**Project Company** A private developer will generally set up a sole-purpose company to assume legal and financial responsibility for the design, construction and operation of a power project. Recourse of the creditors in the event the project fails is limited to the project company's accounts.

**Project Documents** The set of major contracts which define the project. These will typically include the construction contract, the power purchase agreement, the ground lease, the operations and maintenance agreement, the fuel supply and transportation agreements, the steam sales agreement, and the waste disposal agreement. The lender usually has assignment of all of these contracts. Other documents may cover the supply of consumables. Typical major contracts are

- ▶ **Construction Contract** Requires a contractor to build, test and ensure proper performance of the facility. These are usually fixed-price turnkey contracts with provisions for delay and performance damages (see liquidated damages). The facility's ownership is normally transferred to the borrower after milestones indicating near completion are achieved.
- ▶ **Power Purchase Agreement** Determines operating characteristics and pricing of electricity production by the facility that is sold to the purchasing entity, usually a utility, or an industrial facility, or both.
- ▶ **Ground Lease** Project document between the borrower and the owner of the real estate forming the site of the project which describes the terms and conditions of the title and land use.
- ▶ **Operations and Maintenance Agreement** Describes terms and conditions related to the operation and maintenance of the facility by a contractor. Pricing terms may be structured to provide incentives for the contractor to maximize the performance of the facility.
- ▶ **Fuel Supply and Transportation Agreements** Describes terms and conditions related to the fuel supply and transport arrangements secured by the project. Increasingly, a family of contracts is required for service covering multiple parties (commodity, storage, transportation) between the fuel producing properties to the burnertup or boiler.
- ▶ **Steam Sales Agreement** Describes terms and conditions related to the supply of steam produced for consumption by adjacent or nearby industrial facilities.
- ▶ **Waste Disposal Agreement** Describes terms and conditions related to the removal and disposal of hazardous and nonhazardous waste produced by the plant. Particularly important for coal-fired plants and increasingly important for natural gas-fired plants with extensive emission controls.

**Project Finance** A financing approach whereby debt is mobilized on the basis of the performance of a specific project rather than on the strength of an existing company's balance sheet. The lender looks to the cashflows of the project to repay debt, and to the fixed and other assets for security. It therefore involves a careful assessment of the project's cash flow performance under various scenarios to ensure a high probability of repayment on the project's debt. Sometimes referred to as non- or limited-recourse financing.

**Project Risk** The total risk for a project as perceived by the government, developer and potential investors, including commercial, political, and force majeure risks

**Remedies** Actions the lender can take against the borrower in case of a default

**Representations and Warranties** Statements regarding the project and the participants that the borrower certifies as being true at the time they are certified

**Reserve Accounts** Accounts held to provide for foreseeable contingencies Typical reserve accounts include operations and maintenance (or overhaul) accounts, working capital accounts, and debt service accounts These are often required to be filled with available project cash flows, *before* equity distributions are made

**Risk Profile** The level of risk due to political, economic, or financial uncertainty to which an investor is exposed This determines the rate of return that an investor requires in order to tolerate exposure to the level of adversity in any country

**Security Agreements** Documents granting the lender a security interest in the collateral These documents will describe the collateral and the lender's rights and interest in each or all of the collateral Such documents provide for the mortgages or fixed charges to cover land, fixed assets, assignment of a project company's rights under all project contracts, insurances and reinsurances, performance bonds, charges over the project company's bank accounts and book debts, floating charge over all other assets of project company, and provision for local and offshore accounts to control and retain cash flows for the project

**Senior** Indicates an order of payment that has priority over other creditors

**Sovereign Guarantee** Government guarantee, for example, of the obligations of a purchasing utility under a power purchase agreement

**Sponsor** Party that takes a leading role in structuring the project, negotiating the project agreements (power purchase agreements etc ), arranging the financing, negotiating and securing the construction contract, and other tasks associated with project development This party also quite often supplies the majority, or a significant portion, of the equity financing

**Subordinate** Indicates an order of payment that is junior to other creditors This may include debt Payments to equity would always be subordinate to all debt

**Subordinated Loan** A loan advanced by another lender for a portion of the total project debt which is higher risk since the right to repayment is junior to rights of the senior lender Subordinated lenders are typically precluded from many remedies to collect repayments until senior obligations have been met

**Survey** The act of survey relating to the production, transmission, or distribution of electricity and will also denote the acts relating to feasibility study, detailed engineering design, and the works of investigation thereto

**Take Out** The term given to the financial procedure where the construction financing for a project is bought out or converted to long term debt and equity in a project after commissioning

**Tariff** The fixed, daily, or seasonal rates charged for the energy, capacity, and other miscellaneous services for power supply, which in the case of private power developers, are generally included in the power purchase agreement

**Tax Holidays** The legal provision as provided by the host government for exemption of the project company from some or all taxes for a specified period

**Term(Loan)** The number of years until the final maturity of principle

**Term Loan** A loan which is effective between the conversion date and the end of the amortization period (maturity)

**Title** Instrument that provides evidence of the extent of perfect or imperfect ownership of a property or asset

**Turnkey Contract** An arrangement where a contract is given by the project developer to a prime contractor who in turn will be fully responsible for the design and implementation of a project. The Contractor will provide a completed, operational project on a stipulated date, often on a lump-sum basis

**Waterfall** Description of the flow of funds between accounts from receipt of revenues to debt service and equity distributions. The term "waterfall" is used as project revenues are used to fill accounts in order of priority, and cash is not deposited in lower priority accounts until higher priority accounts are filled

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## Appendix B

### Project Agreements Typical List of Contents

#### Preamble

- 1 Definitions and Interpretations
- 2 Project Description
- 3 Conditions Precedent
- 4 Obligations of Government
- 5 Obligations of Project Company
- 6 Guarantee
- 7 Force Majeure
- 8 Representations and Warranties
- 9 Information
- 10 Term and Termination
- 11 Governing Law
- 12 Dispute Resolution
- 13 Notices
- 14 Assignment and Security
- 15 Acquisitions and Transfers of Shares and Assets
- 16 Good Faith
- 17 Amendments
- 18 Immunity
- 19 Financing Documents
- 20 Refinancing
- 21 Performance Assurance
- 22 Miscellaneous Provisions

#### Schedules

- A Power Purchase Agreement

## Appendix C

### Power Purchase Agreements Typical List of Contents

#### Preamble

- 1 Definitions and Interpretations
- 2 Sale and Purchase of Energy and Capacity
- 3 Conditions Precedent
- 4 Term and Termination
- 5 Pre-operation Period
- 6 Control and Operation of the Project
- 7 Testing and Capacity Rating
- 8 Interconnection
- 9 Metering
- 10 Rates and Charges
- 11 Fuel Price Provisions
- 12 Billing and Payment Procedures
- 13 Changes in Law
- 14 Force Majeure
- 15 Representations, Warranties and Covenants
- 16 Liability, Noncompliance and Guarantees
- 17 Insurance
- 18 Governing Law
- 19 Dispute Resolution
- 20 Notices
- 21 Miscellaneous Provisions

#### Schedules

- 1 Project Description
- 2 Financial Assumptions
- 3 Permits and Authorizations
- 4 Escalation
- 5 Technical Limits
- 6 Construction Reports
- 7 Clearances
- 8 Development Milestones
- 9 Interconnection and Transmission Facilities
- 10 Commissioning and Testing
- 11 Metering Standards and Testing
- 12 Dispatch Procedures
- 13 Capacity and Energy Payments

## Appendix D

### Project Closing Checklist

#### Transaction Documents

- ▶ Credit/Loan Agreement
- ▶ Subordinated Debt or Equity Contribution Agreements
- ▶ Lender Fee Letter

#### Project Documents

- ▶ Project Agreement
- ▶ Power Purchase Agreement
- ▶ Construction Agreement
- ▶ Operation and Maintenance Agreement
- ▶ Deeds or Site Lease

#### Insurance

- ▶ Political Risk Insurance
- ▶ Commercial Insurance Contract
- ▶ Certifications

#### Security Documents

- ▶ Mortgage/Deed of Trust
- ▶ Stock Pledge Agreement
- ▶ Partnership Pledge Agreement
- ▶ Uniform Commercial Code Financing Statements
- ▶ Security Agreement
- ▶ Consent and Agreement
- ▶ Guaranty
- ▶ Collateral Agency Agreement
- ▶ Intercreditor Agreement

#### Corporate Documents

- ▶ Certified Articles of Incorporation
- ▶ Certified By-Laws
- ▶ Certified Corporate Resolutions
- ▶ Good Standing and Tax Certificate

#### Approvals, Licenses and Permits

- ▶ Project License
- ▶ All Other Approvals as per the Electricity Act, 2049, and the Electricity Rules, 2050, and all other relevant Laws applicable
- ▶ Land Use Compliance Permit
- ▶ Encroachment/Access Permits

- ▶ Environmental Review/ Impact Compliance
- ▶ Permits for foreigners to invest in a Nepalese company and to borrow from Foreign Lenders
- ▶ A Permit to open and maintain bank accounts in foreign currency inside and outside Nepal
- ▶ An exemption from loan registration fees (including mortgage fees)
- ▶ A permit to mortgage assets or pledge shares to foreign lenders to this type of project

### **Legal Opinions**

- ▶ Borrower's Special Counsel (corporate standing and procedures, enforceability, no conflict, no approvals)
- ▶ Borrower's Local Counsel (creation, perfection and priority of liens and security interests, environmental and land use compliance)
- ▶ Third Party Counsel (enforceability)
- ▶ Lenders' Counsel

### **Miscellaneous Closing Documents**

- ▶ Independent Engineer's Report
- ▶ Independent Engineer's Certificate
- ▶ Insurance Policies or Certificates
- ▶ Insurance Adviser's Certificates
- ▶ Title Insurance Policies
- ▶ Environmental Consultant's Report
- ▶ Operating Budget
- ▶ Application for First Advance
- ▶ Borrower's Certificate re Representations/Defaults
- ▶ Borrower/Parent Financial Statements
- ▶ Uniform Commercial Code Search Reports

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## Appendix E

### Sample Construction Loan Agreement Table of Contents

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- i Lien Search Reports
- j Uniform Commercial Code-1 Financing Statements
- k Pledged Stock
- l Partnership Interest Pledge Requirements
- m Title Insurance
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  - g Information Relating to Construction
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  - i Environmental Matters
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  - k Certain Events
  - l Loss of Necessary Project Approvals
  - m Other Information
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- 5 04 Compliance with Law
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- 5 06 Insurance
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- 7 07 Funding of the Debt Service Reserve Account
- 7 08 Mandatory Prepayments
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- 7 10 Payments from the Cash Collateral Account
- 7 11 Termination of the Cash Collateral Account
- 7 12 Permitted Distributions

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  - f Security Documents
  - g Judgements
  - h Environmental Matters
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  - k Event of Loss
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**Schedule 1 Banks and Commitments**

## Appendix F

### Lender's Due Diligence Checklist

#### Borrower/Parent Due Diligence

- ▶ Corporate Organization
- ▶ Good Standing/Payment of Taxes
- ▶ Ownership/Capitalization
- ▶ Sole Purpose Corporation
- ▶ Financial Statements
- ▶ Uniform Commercial Code Searches
- ▶ Experience/Reputation

#### Required Contractual Arrangements

- ▶ Project Agreement
  - Authorizations
  - Guarantees
  - Currency Matters
  - Tax and Duty Items
  - Changes in Law/Regulations
  - Force Majeure
  - Insurance
  - Expropriation
- ▶ Power Purchase Agreement
  - Energy/Capacity Pricing Mechanisms/Escalation
  - Dispatchability
  - Construction/Operation Deadlines
  - Term of Contract
  - Interconnection Requirements/Costs
  - Security/Letter of Credit Requirements
  - Defaults/Remedies - Liquidated Damages
  - Cross Defaults
  - Regulatory Approvals
  - Power Purchaser's Financial Condition
  - Power Purchaser Liens/Purchase Options
- ▶ Site Control and Access
  - Owned or Leased
  - Term of Control
  - Title Insurance
  - Easements/Rights-of-Way for access, transmission, and interconnection facilities
  - Defaults/Remedies

- ▶ Engineering and Construction
  - Turnkey Obligations
  - Performance Tests/Warranties
  - Liquidated Damages/Buydown
  - Payment and Performance Bonds
  - Contractor Experience/Financial Condition
- ▶ Operation and Maintenance
  - Scope of Obligations
  - Firm Price vs Cost-Plus
  - Liquidated Damages/Performance Incentives
  - Ability to Terminate/Replace
  - Contractor Experience/Financial Condition

### **Required Permits And Approvals**

- ▶ License
  - Production and/or Transmission
  - Survey Report/Feasibility
  - Environmental Effects
  - Project Description
  - Mode of Finance
  - Land Acquisition
- ▶ General
  - All other requirements as per the Electricity Act, 2049 (1992) and the Electricity Rules, 2050 (1993), and all other relevant laws applicable
- ▶ Conditional Use/Land Use Compliance
- ▶ Encroachment/Access Permits

### **Miscellaneous Project Due Diligence**

- ▶ Independent Engineer Review
  - Technical Feasibility/Reliability
  - Costs to Construct/Operate
  - Compliance with Permits/Approvals
  - Compliance with Power Sales Agreement, etc
  - Adequacy of Performance Tests, Warranties and Liquidated Damages
- ▶ Environmental Consultant Review
  - Receipt of Necessary Permits/Approvals
  - Compliance with Laws/Regulations/Permits
- ▶ Insurer Adviser Review
  - Coverages
  - Limits/Deductibles
  - Lender Endorsements/Rights
- ▶ Site Survey

## Appendix G

### Independent Engineer Typical Scope of Work

#### Preconstruction Phase

- ▶ Obtain Proper Documentation
  - Initial Project Scoping Meeting with Client
  - Site Visit
- ▶ Review Conceptual Site
  - Project Design Requirements
  - Conceptual Design of Project Facilities
- ▶ Review Engineering, Procurement, and Construction
  - Engineering, Procurement and Construction (EPC) Contract or Construction and Equipment Supply Contracts
  - Guarantees and Liquidated Damages
  - Construction Schedule
  - Total Project Construction Cost Estimate
  - Drawdown Schedule
- ▶ Review Performance and Acceptance Testing Procedures
- ▶ Review Commercial Operation and Pro Forma
  - Operations and Maintenance (O&M) Agreement
  - Technical Input to the Project Pro Forma
- ▶ Review of Power Purchase and Interconnection Agreements
- ▶ Review of Permits and Licences
- ▶ Environmental Site Assessment
- ▶ Evaluate Overall Consistency of Project Documentation
- ▶ Prepare Letter Report

#### Construction Phase

- ▶ Attend Construction Monitoring Kick-Off Meeting
- ▶ Attend Monthly Project Review Meetings at Engineer's Design Office or Project Site
  - Review Services Relating the Design
  - Review Services Relating to Procurement
  - On-Site Observation of Services Relating to Construction
- ▶ Review Status of Change Orders to Construction Contract
- ▶ Prepare Independent Engineer's Certificate
- ▶ Verify Mechanical Completion

#### Completion Phase

- ▶ Review of Performance Testing Procedures
- ▶ Witness Performance Tests
- ▶ Review Contractor's Test Report
- ▶ Submit Letter Report to Lender

- ▶ Verify Letter Report to Lender
- ▶ Verify Project Completion

**Other Services**

- ▶ Assist with Contract Preparation and Negotiation
- ▶ Assist in Developing Performance Test Criteria
- ▶ Analyze Change Orders to Turnkey Construction Contracts
- ▶ Assist in Resolving Issues Prior to Closing
- ▶ Assist in Syndication of Loan

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## Appendix H

### Sample Representations And Warranties

To induce the Bank to enter into this Agreement, to issue Letters of Credit and to make Advances hereunder, the Project Company warrants and represents to the Bank that at the date hereof

#### **Section 1 - Organization, Standing, etc**

The Project Company is a corporation duly organized and validly existing and in good standing under the laws of Nepal and has all requisite corporate power and authority to carry on its business as now conducted, to enter into the Loan Documents and to perform all of its obligations under each and all of the foregoing. All corporate action necessary for the valid execution, delivery and performance of the Loan Documents has been duly authorized and taken.

#### **Section 2 - Validity**

The Loan Documents constitute the legal, valid and binding obligations of the Project Company enforceable in accordance with their respective terms (subject to limitations as to enforceability which might result from bankruptcy, insolvency or other similar laws affecting creditors' rights generally). The execution, delivery and performance by the Project Company of the Loan Documents will not contravene, result in the breach of, or constitute a default under, any provision of law or regulation applicable to the Project Company or the Project or the Certificate of Incorporation or bylaws of the Project Company or any other agreement or instrument to which the Project Company is a party or by which it or its property may be bound or result in the creation of any lien thereunder except in favor of the Bank.

#### **Section 3 - Compliance With Law**

No consent, approval, authorization of, or registration, declaration or filing with, any governmental authority is required on the part of the Project Company in connection with the execution and delivery of the Loan Documents, or the performance of or compliance with the terms, provisions or conditions hereof or thereof.

#### **Section 4 - Title to Properties**

The Project Company has good and marketable title to its real properties and good and sufficient title to, or other interest in, its other respective properties and assets to the extent shown on the Deeds of Trust, in each case free and clear of all liens, restrictions and encumbrances except for those which have been specifically disclosed in writing to the Bank. No other material properties or material assets, except those shown on the plans and specifications for the Project to be acquired with the proceeds of Advances or with the Project Company's own funds, are necessary for the completion, ownership and commencement of operation of the Project.

#### **Section 5 - Tax Returns**

All appropriate country, state and local income tax returns which are required to have been filed for all of the Project Company's taxable periods either have been filed or timely extensions obtained. All taxes as shown on said returns have been paid when due. The Project Company knows of no proposed material tax assessment against it for which adequate reserves have not been established.

## Section 6 - Litigation

As a Condition Precedent, the Bank shall have received a letter from counsel to the Project Company wherein shall be listed all actions, suits and proceedings pending or threatened against the Project Company immediately prior to the Closing Date so far as known to such counsel, or affecting the Project Company immediately prior to the Closing Date so far as known (without independent investigation) to those lawyers in the law firm representing the Project Company who are working on Project Company legal matters, and including such counsel's estimate as to the probable outcome of any such actions, suits and proceedings if counsel can make such an estimate

Except as disclosed in the letter of counsel referred to above, there are no actions, suits or proceedings pending or threatened against or affecting the Project Company (except that this representation with respect to actions, suits or proceedings threatened against the Project Company or actions, suits or proceedings pending or threatened which may affect the Project Company is made only to the best of the Project Company's knowledge), at law or in equity, or before any governmental board, agency or instrumentality or any arbitrator which, if determined adversely to the Project Company, would have a material adverse effect on the condition (financial or otherwise), operations or properties of the Project Company. The Project Company is not in default with respect to any material order, writ, injunction or decree of any court or governmental board, agency or other instrumentality

## Section 7 - Undisclosed Liabilities

The Project Company has no material liabilities of any nature, whether accrued, absolute, contingent or otherwise, except for (i) liabilities to contractors and vendors in connection with Project Costs and disclosed on the Project Budget, (ii) indebtedness to the Guarantor, (iii) liabilities, if any, with respect to the matters disclosed in the letter of counsel delivered pursuant to Section 6, Litigation above and (iv) liabilities arising in the ordinary course of business, none of which alone or in the aggregate has a materially adverse effect upon its assets or financial condition

## Section 8 - Licenses

In accordance with the Electricity Act, 2049 (1992), the Project Company has license(s) from His Majesty's Government of Nepal meeting the requirements of the Electricity Regulation, 2050 (1993). The license(s) authorizes the construction and operation of the Project, subject to the terms and conditions set forth in the license. The license is in full force and effect and the Project Company has complied in all material respects with all terms and conditions which are required to be complied with as of the date of this Agreement. No requests for amendment of the license are pending.

## Section 9 - Power Purchase Agreement

The Power Purchase Agreement is valid, binding and enforceable with respect to both the Nepal Electricity Authority and the Project Company. The Power Purchase Agreement has been approved to the extent necessary for the continuation of the Project by each governmental agency whose approval is required under applicable laws and regulation.

## Section 10 - Project Agreement

The Project Agreement is valid, binding and enforceable with respect to both His Majesty's Government of Nepal and the Project Company.

**Section 11 - Approvals**

Except as disclosed in the appropriate exhibit attached to this agreement, the Project Company has obtained all franchises, permits, licenses, exemptions and other rights and approvals necessary to commence construction of, complete and operate the Project. The Project and the intended uses and operations thereof comply in all material respects with all zoning laws, local ordinances and regulations of governmental authorities having jurisdiction over the Project and the users thereof, and with restrictions and instruments applicable thereto.

**Section 12 - Disclosure**

No information, exhibit or report furnished by the Project Company to the Bank in connection with the negotiation and preparation of this Agreement or the other Loan Documents contains any material misstatement of fact or omits to state a material fact necessary to make the statements contained therein misleading.

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