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Project Finance

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

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Milbank, Tweed, Hadley & McCloy LLP's Project, Energy and Infrastructure Finance group is the leading choice for the financing and development of the world's most critical and complex projects. More than 100 dedicated attorneys in the US, the UK and South America and across Asia collaborate efficiently to meet the demands of the most challenging cross-border deals. The firm has had a hand in many of the most significant energy and infrastructure projects, from a first-of-its-kind toll road in Latin America, to a wireless telecom build-out in Southeast Asia. Transactions span an array of industries, including oil and gas, petrochemicals, renewables, power and energy, infrastructure, telecommunications, space and satellite, waste disposal and recycling, mining and metals, natural resources, pulp and paper, and transportation, from ports and airports to shipping.

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1. Project Finance Panorama

1.1 Recent History and Expected Developments

The USA has long welcomed private debt and equity capital to fund large infrastructure projects and remains one of the world's oldest and largest markets for project financings. Various long, medium and short-term financing structures may be deployed, allowing for great flexibility in accommodating and balancing competing interests among the tranches of debt providers and equity investors. Non-recourse senior secured financing is prevalent for the development and construction of a wide range of capital-intensive investments, particular in the energy and infrastructure sectors. Energy projects (such as power plants, high-voltage transmission lines, and midstream oil and gas assets) are frequently financed by private developers using non-recourse debt. The goal of sponsors and equity investors is frequently to maximise after-tax returns through increased leverage, requiring contractual allocation of risk so as to maximise debt capacity. Of particular interest is the advancement of renewable energy technology coupled with favourable regulatory and tax-incentives that have served as a catalyst for growing investment in the US market. In the renewable energy space, so-called "tax equity" investors inject capital for operating projects so that developers can take advantage of production tax credits or investment tax credits, and other tax attributes of projects. Large infrastructure projects in the transportation sector (such as roads, bridges, airport and rail facilities) also attract project financing, often through public-private partnerships.

1.2 Institutions Typically Acting as Sponsors and Lenders

Funding for US projects is available from a wide range of sources: private sponsors; strategic investors; financial investors; institutional investors; commercial or investment banks; foreign development banks; large corporates; private equity funds; and specialised infrastructure funds. Equity sponsors include a wide range of project developers, from large corporate investors (many of whom are affiliated with larger energy companies) to smaller independent developers. Experienced developers lacking a large balance sheet, or seeking to reduce risk, often partner with financial investors such as infrastructure funds. Debt for construction of new projects is typically sourced from large commercial banks, many of which are based outside the USA. Long-term debt for projects, once built, may be provided by banks, institutional investors (such as pension funds or insurance companies), or private funds. It is possible for a project to be financed through equity (including "tax equity" for renewable energy projects) plus either construction or term bank debt or institutional debt (either as term loans or through the private placement of notes or bonds) or, if the project is large enough, a combination. These debt facilities are typically secured.

Many projects also benefit from smaller working capital lines of credit (which constitute revolving debt) and from letter of credit facilities to meet credit support requirements from off-takers or other counter-parties. Lastly, some projects enter into hedging arrangements, which are often secured, to mitigate interest rate risk or commodity risk. These hedges are often provided by banks that are also part of the syndicate providing long-term debt while the project is in commercial operation.

1.3 Public-private Partnership Transactions

Public-private partnerships (PPPs or P3s) are permitted in some but not all US states as a device for government agencies to transfer risk and responsibility to private operators of infrastructure facilities. The US market has long been characterised by a series of very large projects undertaken in states that have enabling P3 statutes (such as Texas, California, Florida and Virginia, to name a few), combined with an absence of a single model or federal umbrella agency to standardise project structures and terms. As such, many procurements undertaken as P3s in the USA rely on newly educating granting authorities and then negotiating bespoke concession terms, greatly increasing transaction costs, reducing deal flow, and concentrating the market on a handful of mega-projects. Nonetheless, given the potential benefits of lower life cycle costs, greater "value for money", access to private capital, and risk sharing, the P3 model continues to be an important way for some significant US infrastructure projects to be built, especially for roads and bridges and, more recently, airport facilities. Rail projects, parking concessions, and water supply and treatment facilities have also provided recent P3 successes, as have social infrastructure projects such as courthouses, public universities and military housing. It remains to be seen whether promised federal initiatives to boost infrastructure investment will foster new P3s alongside more traditional public procurements of new or rehabilitated facilities.

1.4 Main Issues Considered When Structuring the Deal

As is always the case in a project financing structure, the main issues include securing a long-term, stable revenue source and allocating risks to the parties best situated to bear the risks. Additionally, project sponsors seek to maintain flexibility to realise future equity returns either by selling projects, once placed in service, to third parties or to affiliate companies (often known as "yieldcos") that hold pools of operating projects with predictable cash flows or by releveraging the operating projects through portfolio financings at a holding company level or backleverage.

2. Guarantees and Security

2.1 Assets Typically Available as Collateral to Lenders

Project finance lenders for projects located in the USA typically receive a first priority lien on all of the borrower's assets together with a pledge of the equity held by the sponsors in the project operating company. The documentation to create the liens, and the method of perfection, depend on the nature of the collateral. Validity, perfection and priority of liens are established under state law, not US federal law, for most types of collateral.

In general, liens on personal property are created under a security agreement or similar document. A filing under the applicable state Uniform Commercial Code (UCC) may be made to perfect security interests in most personal property, whether tangible or intangible. In addition, accounts, contracts, and general intangibles may be pledged contractually, and security agreements may cover after-acquired assets. UCC Article 8 governs security interests in securities, while UCC Article 9 governs liens in most other personal property. As a rule, perfection of liens is achieved by either possession, control or notice, which may include notice through a filing or recording in a central public registry applicable to the type of asset being pledged. Special rules apply to perfection of liens in certain types of personal property, such as timber or agricultural products.

State law similarly governs the creation and perfection of security interests in real property. Liens in real property are typically effected by means of either a mortgage or a deed of trust, depending on the state. Enforcement of a mortgage typically requires a judicial foreclosure. Deeds of trust contain a power of sale that could permit a secured party to foreclose on the pledged real property without judicial action following an event of default.

2.2 Charge or Interest over All Present and Future Assets of a Company

Typically, in debt financings of energy or infrastructure projects lenders will require perfected liens on all assets of the special purpose "project company" borrower. The UCC permits liens to attach to personal property that is described broadly as "all assets" of the debtor. Likewise, liens may attach to items falling within a particular category of personal property (such as "inventory" or "accounts receivable") described generally in the granting clause of the security agreement, even though the property in that category may change over time. If the security agreement covers "after-acquired" property, then no additional action is required to bring new personal property that is subsequently acquired within the scope of the original lien.

2.3 Costs Associated with Registering Collateral Security Interests

The costs associated with registering collateral security interests will vary depending on the state in which the security interest in perfected and the type of collateral. These costs typically include filing fees, search fees, and fees for the agent who registers the security interest. Pledges of real property interests may entail significant additional costs, such as mortgage recording taxes tied to the amount secured by the mortgage. Documentary stamp taxes are not the norm in the USA, though some states (such as Florida) do assess fees for documentary stamps on instruments conveying an interest in real property.

2.4 Granting a Valid Security Interest

For a lien to attach, as a rule, three conditions must be satisfied. First, value must be given in exchange for the security interest granted by the debtor. Second, the debtor must have rights in the collateral being pledged. Third, the lien must be stated in an "authenticated" (that is, signed by the debtor) security agreement expressly granting to the secured party a security interest in the collateral, and the collateral must be clearly described in the security agreement. Depending on the nature of the security interest being granted, "all assets of the debtor" may be identified or, in the case specific items being granted, a specific collateral description may also be attached to the security document. It is generally not necessary to specifically identify each pledged item within a category of personal property in order to create or perfect a lien in that type of property. Security interests in real estate, in contrast, must specifically identity the parcel or parcels of pledged land in the relevant document in order for the mortgage or deed of trust creating the lien to be duly recorded.

2.5 Absence of Other Liens

Lenders and financing parties typically require lien searches prior to the funding of loans to ensure that their security interest is properly perfected and that the pledged property is free of adverse claims or interests. Liens in personal property may be recorded in a centralised registry in the relevant state (typically the state in which the debtor or its principal office is located or the state in which the entity is organised). Specific registries may exist for certain types of movable personal property, such as vessels or motor vehicles (state registries) or aircraft (a national registry).

Real estate liens on a particular parcel of land (whether the land is owned or leased by the debtor) are maintained at local levels (counties) within each state. Clear title may be confirmed, or adverse interests of record may be identified, in each case by a title search in the real property records. The title search may be performed by a title company in the county where the real property is located and is often accompanied by a physical survey to identify encroachments. In the USA, title insurance may be obtained, which insures against financial loss from defects in title to real property and from the invalidity or unenforceability of mortgage loans.

It is possible for additional security interests to be placed on most types of collateral, such that a subsequent secured party's liens are subordinated or subject to any prior liens. Subordinated liens are not always capable of perfection so long as perfected senior liens remain in place, such as for property (eg, certain types of pledged securities or cash) relying on possession for lien perfection.

2.6 Releasing Typical Forms of Security

Security interests may be released through a formal, written release, accompanied by the filing a UCC termination statement (for personal property) or a mortgage release (real property), or the return of any collateral in which the lien was perfected by possession by the secured party. The methods by which the release of a lien is evidenced mirror the mechanism by which that lien was previously perfected.

3. Enforcement

3.1 Secured Lender Enforcing its Collateral

Circumstances of a secured lender's rights of enforcement are typically identified in the loan agreement, and include enumerated events of default such as the failure to make timely payments of principal or interest on the loan, breaches of contract and covenant defaults, or bankruptcy of the borrower. If the borrower does not or cannot cure the default, the secured party will typically have the right to enforce its security interest against the collateral. Remedies may include foreclosure, sale to a third party, or retention of the collateral. The applicable state laws often require the secured party to proceed in a commercially reasonable manner and to give proper notice to the borrower. In practice, in distressed project financings, lenders entitled to foreclose on a project prefer (for speed and economy) to exercise their rights on the pledged equity in the project company rather than foreclosing on each asset of the project company. Enforceability of guarantees is likewise determined by the laws of the state the law of which governs the guaranty.

3.2 Upholding Foreign Law

Generally, parties may elect to have the law of a foreign jurisdiction govern a contract. Such a choice of law should be enforceable in judicial proceedings to enforce the contract. However, some states have laws that prohibit their state courts from considering foreign laws, even in contract disputes. Other states (notably New York) have statutes expressly honouring the enforceability of contractual choice of law elections if certain simple conditions are met.

3.3 Judgment Without Retrial

A judgment given by a foreign court may be enforced in the USA so long as a judicial proceeding is commenced in a local court (whether federal court or state court) and personal jurisdiction over the parties can be maintained. The enforceability of the foreign judgment depends on the law of the state in which the enforcement suit is commenced. Foreign judgments may not otherwise be directly enforced in the USA such as by means of letters rogatory. In practice, most US courts will not re-open the merits of the foreign judgment absent violations of due process (such as failure to give adequate notice to the parties), fraud or other procedural defects in obtaining the foreign judgement, lack of jurisdiction, or violation of public policy. Foreign arbitral awards may be confirmed and enforced in US courts, and the USA is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and other similar international treaties.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

While specific regulations may provide restrictions limiting or barring government-owned entities, states, or local governments from borrowing from foreign lenders, generally private parties are not prohibited from borrowing loans from non-US lenders. Although foreign lenders are not restricted from granting loans, all lenders may be subject to state or federal regulation and requirements related to conduct of a banking business in the USA. Such requirements could include bank examinations, maintenance of a branch or representative office, capital adequacy requirements, anti-money laundering and know-your-customer requirements, state and federal taxation (including income taxes and withholding taxes on certain payments), usury limitations, record-keeping requirements, limitations on non-banking businesses, and so forth. Regulation of banks and other financial institutions in the USA can be quite extensive.

4.2 Restrictions on Foreign Lenders on Granting of Security or Guarantees

A borrower in the USA may grant security interests or issue guarantees to a foreign lender. However, foreign lenders might not be able to acquire US assets (including collateral taken upon a foreclosure) unless the lenders can comply with federal regulations limiting certain acquisitions on national security grounds. As such, foreign lenders or their non-US affiliates may be unable to acquire certain types of ownership interests in or control of sensitive projects. Separately, some states require lenders from out of that state to comply with local registration or licensing requirements in order for the lenders to receive or enforce mortgages against real property located in that state. Failure to comply with those requirements can render the mortgages unenforceable or subject the mortgage lender to fines or penalties.

4.3 Maintenance of Offshore Foreign Currency Accounts

US borrowers may maintain offshore accounts, though they are highly unusual in US project financings. Any US person maintaining foreign accounts must comply with reporting and tax requirements applicable to such accounts.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing or Project Agreements

Real estate documents must comply with local recordation and filing requirements for the interests therein to be conveyed. For energy projects, regulatory filings with the Federal Energy Regulatory Commission, regional transmission organisations/independent system operators or state utility commissions may be required depending on the nature of the project contract (such as power purchase agreements or interconnection agreements or transfers of controlling interests in regulated assets). Energy hedges may be subject to reporting requirements to the extent constituting regulated derivative contracts. The kinds of filings required vary greatly depending on the type of project and contract.

5.2 Licence Required for Owning Land or Natural Resources

US law generally does not restrict foreign ownership of land or natural resources in the USA. However, acquisitions of some assets may be subject to review by the Committee on Foreign Investment in the United States (CFIUS) and presidential approval. Foreign ownership of real property in the USA may trigger special withholding taxes.

5.3 Recognition of Agent and Trust Concepts

Agency and trust concepts are recognised and are used commonly in project finance transactions in the USA.

5.4 Rules Governing the Priority of Competing Security Interests

The rules governing the creation, validity, perfection and priority of security interests vary by state within the USA. Priority of security interests granted by a common borrower is generally established by either chronology of recording and perfection or through inter-creditor agreements. Contractual and structural subordination are each permitted and both are common. Subordination and priority of liens, and the priority of secured creditors over unsecured creditors, are generally honoured in bankruptcy and insolvency proceedings subject, as in all cases, to equitable considerations.

5.5 Requirements of Local Law

The project company may be organised in any jurisdiction. Most project companies are organised under state law as either limited partnerships or limited liability companies in order to optimise various goals: (i) operational and management flexibility, including differing control rights or variability in allocations and distributions among the investors; (ii) limited liability for investors; and (iii) tax efficiency.

6. Bankruptcy and Insolvency

6.1 Availability and Practice of Company Reorganisation Procedures

Reorganisation and bankruptcy procedures are widely available for companies in the USA under both federal and state law. Liquidations are not mandatory and reorganisations or restructuring of bankrupt debtors is common when the project assets and cash flows are likely to be sufficient to maintain a going concern (once the debtor's capital structure is repaired) in order to maximise creditor recovery. In the event a project company becomes subject to bankruptcy proceedings or when an insolvency event is imminent, financing parties will typically work closely with the project company, its owners and management to ensure the project remains in operation. In the worst case scenario, secured lenders or an agent or receiver acting on their behalf may take ownership of the project and either hire a replacement operator or sell the project to a successor owner. It is not common for foreclosing lenders to retain ownership of distressed assets long term.

6.2 Commencement of Insolvency Processes Impacting Lender's Rights

Typically the commencement of insolvency constitutes a default under the project financing agreements if another default event has not already occurred and is continuing. Ordinarily, if any default remains uncured, the financing parties may enforce their rights under the financing agreement, such as accelerating the loans and exercising remedies as a secured party against the collateral. Once a borrower becomes subject to bankruptcy proceedings, however, the "automatic stay" blocks creditors from taking unilateral action against the borrower or its assets (including the giving of notices of default or foreclosure) without the consent of the bankruptcy court. For this reason, many financing documents contain provisions automatically triggering a default and accelerating the debt with no notice requirement immediately upon a bankruptcy of the borrower.

6.3 Payment Order to Creditors on a Company's Insolvency

Secured creditors typically have rights senior to unsecured or trade creditors in a bankruptcy, at least with respect to pledged collateral, and all creditors come ahead of equity absent a reorganisation plan or other agreement among the parties that is approved by the bankruptcy court. Some claims (such as government claims for unpaid taxes) may come first, but – unlike in other countries – the USA generally does not provide super-priority claim status for workers' unpaid employment or pension claims.

6.4 Risk Areas for Lenders

Since the financing parties of energy or other infrastructure projects are typically large banking institutions or institutional investors without direct expertise in operating non-financial assets, lenders may face elevated risks if a borrower becomes insolvent. These risks may be especially challenging if the lenders must step in (directly or indirectly) as operators of the project. In practical terms, the challenges faced by lenders in an insolvency of a borrower include:

- realisation on collateral and handling competing creditor claims;
- preserving project cash flows without contributing additional funds;
- maintaining project contracts and relations with key suppliers and offtakers;
- control of the business; and
- avoiding additional liabilities (such as environmental liabilities) incident to ownership or control of the asset.

7. Tax

7.1 Payments to Lenders Subject to Withholding Tax

Subject to certain exceptions, payments of principal, interest or other payments to lenders are not subject to withholding tax in the USA. Most types of US source income paid to a foreign person are subject to a withholding tax of 30%, although a reduced rate or exemption may apply if stipulated in the applicable tax treaty.

7.2 Taxes, Duties, Charges or Tax Considerations Relevant to Lenders

Lenders may be subject to various taxes on income or gross receipts, and to other taxes, duties or charges imposed by state and federal governments. Taxation can be complex and varies by state.

7.3 Usury Laws or Other Rules Limiting the Amount of Interest Charged

Most states limit the amount of interest that may be charged on loans. These limits may apply even in commercial transactions. In practice, these limits are substantially higher than the interest rates currently charged in project financings. Usury laws vary by state.

8. Applicable Law

8.1 Law Typically Governing Project Agreements

Most project agreements are stated to be governed by the law of the jurisdiction in which the project is located.

8.2 Law Typically Governing Financing Agreements

The laws of the State of New York are often selected to govern financing agreements for larger projects or for projects funded by multi-national banks or institutional investors. Security agreements may also be governed by New York state law, although real estate security agreements are usually governed by the law of the state in which the pledged real property is located. Equity pledge agreements may be governed by the law of the jurisdiction in which the pledged entity is organised (often either the State of Delaware or the state in which the project is located).

8.3 Matters Typically Governed by Domestic Law

US transactions are almost always governed by US law or the law of a US state.

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9. Islamic Finance

9.1 Development of Islamic Finance

Islamic finance is not relevant to the project finance market in the USA.