PROJECT FINANCE IN AN EVER-CHANGING WORLD

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Project finance is essentially a leveraged lending transaction in which lenders fund a substantial portion of the capital cost of establishing a new business that will construct, own and operate an asset, such as a drilling rig, a mine, a manufacturing or processing facility, a satellite, an airport or some other type of infrastructure, largely in reliance on projections of the business' revenue-generating capacity. The reliability of those revenues is heavily dependent on the business' underlying commercial viability and the legal certainty of the risk allocation in its key contracts. Both of those variables: commercial viability and legal certainty are in turn subject to a wide range of economic and political influences that are constantly evolving, frequently in ways that are hard to anticipate.

As these influences evolve, so do the markets in which we as project finance lawyers operate. On a macro and global level, these influences have a significant effect on the aggregate levels of project finance activity and in determining in which regions and industries it will occur. For example, in recent years the growth of the BRIC economies (that is, Brazil, Russia, India and China) and the CIVETS countries (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa), among others, have engendered extraordinary levels of investment for power generation, telecommunications and infrastructure projects within the regions and, perhaps more notably, for a globally increasing demand for energy and natural resources.

The viability of a wide range of large-scale natural resource and oil and gas projects in ever-more remote parts of the world has thus been underpinned by the increase in commodity prices brought about in large part by demand from these high-growth economies. In many cases, the cost of implementing these projects has been enormous, giving rise to the "mega-projects" that have become a feature of our market. In assessing them, lenders have been prepared to rely on robust revenue projections based on assumptions that oil and other commodity prices will remain at newly elevated (although prudently discounted from their peak) levels indefinitely. As a result, the financing of projects whose capital costs may once have been seen as too high to be viable in a low commodity price environment is now being seen as a viable proposition.

Of course, all economies face inevitable cycles, and even the most optimistic forecasters have come to recognise that growth across many of the emerging markets, most notably China, has tapered. Likewise, although a degree of optimism has emerged in some parts of the developed world, much of it remains mired in recession. With a consequent reduction in demand for basic goods, the pace of investment in metals, mining and other natural resource projects has now slowed, and projects that were financed on the basis of optimistic demand forecasts may face some degree of duress. However, most projects have life spans that extend through multiple economic cycles, and thus decisions as to whether to proceed with them may not turn solely on current economic indices, and most existing projects have been structured soundly enough to withstand even significant downturns.

Other developments can be far less foreseeable. Dramatic political changes can have a significant impact on the regions in which projects are being developed, both positive (as was the case with the end of the Cold War and the relative stabilisation of a number of African and Latin American countries) and negative (as we see from the continuing disruption in Ukraine and across various regions in the Middle East). Changes of that sort defy prediction and will inevitably affect both the volume and nature of deals.

The viability of an individual project can be particularly vulnerable to changes in the domestic policy of its host state, and in recent years we have seen a resurgence in "resource nationalism" that has led a number of host governments to seek to renegotiate or even terminate concession agreements that may have been awarded by their predecessors in office. As a project comes to completion or as its revenues increase over time, the extent of the incentives given by the host state (often in the form of tax holidays or what may be seen to have been concessionary royalty payments) will frequently come under domestic scrutiny. This has led to a spate of disputes between investors and states, and where a final investment decision has yet to have been made, to the deferral of a number of long anticipated projects. Whether this sort of dispute constitutes rectifying the wrongs of the past or simply opportunistic expropriation may depend on the perspectives of those forming that judgement.

Technological advances have also had a significant impact on our markets. By way of example, new drilling technologies have allowed the commercial exploitation of huge US gas reserves that had previously been viewed as locked in. Facilities that were not long ago implemented to allow the import of liquefied natural gas to North America from Trinidad, Nigeria and the Middle East are being re-engineered (at great cost) into platforms for the export of America's now abundant natural gas to Asia and Europe. Global LNG markets are also being transformed through advancements in floating LNG production platforms. Technological progress has benefited other sectors as well, ranging from telecommunications to the nuclear industry, where a range of countries are undertaking ambitious nuclear programmes that feature heightened safety standards.

EDITORIAL POLICY AND SELECTION CRITERIA: NOMINEES HAVE BEEN SELECTED BASED UPON COMPREHENSIVE, INDEPENDENT SURVEY WORK WITH BOTH GENERAL COUNSEL AND PROJECT FINANCE LAWYERS IN PRIVATE PRACTICE WORLDWIDE. ONLY SPECIALISTS WHO HAVE MET INDEPENDENT INTERNATIONAL RESEARCH CRITERIA ARE LISTED

The project finance markets have also been affected by the occurrence of a range of other unpredictable events, some of which have had catastrophic effects. One can debate whether the impact of a tsunami at Fukushima should have been anticipated, but the consequent changes in the power generation mix in Japan, Germany and even the US have been far reaching, with increased demand for natural gas-fired and renewable generation to replace nuclear capacity. We have also seen projects whose operations have been impaired not only by acts of God, but also by the acts of a tired or distracted operator, which may be the result of the strains being placed on the world's limited engineering resources by the demands of the many "mega-projects" coming to fruition at the same time.

Global investment flows have also been influenced by the tides of broad-based social demands. In recent years, a growing recognition that our environment has been threatened by escalating levels of carbon emissions has encouraged the development of wind and solar power generation (which is frequently project-financed) in most corners of the world, but, to the extent that the cost of renewable generation of this sort requires a subsidy to be competitive, the political will to fund those subsidies may weaken in the face of competing budgetary demands. Other demands, frequently articulated by a wide range of non-governmental organisations, have also done much to encourage financial institutions to apply heightened scrutiny to mitigate the adverse impacts on local populations that large-scale projects may have. These demands have driven improvements in the manner in which such projects are implemented (often at significant cost), thereby enhancing their long-term sustainability. These demands have also halted the development of a number of projects that could not meet these heightened standards.

With sponsors in a continuing search for natural resources to exploit and more generally for attractive investment opportunities, we continue to see a flow of projects that are "first in country". Each country in which a project is developed has its own unique legal environment, and legal advisers have had to assess how traditional legal precepts will be treated in the courts of these new host states. What may have been an accepted risk allocation in one country may not be achievable in the next. Where efforts at harmonisation have been undertaken, as has been the case in much of Francophone Africa through the convention of the Organisation for the Harmonisation of Business Law in Africa, some of these legal challenges have been addressed, at least in part. However, as more projects are undertaken in countries that feature underdeveloped laws and unsophisticated courts, the challenge of putting in place reliable contracts and lender security packages can be significant, requiring creativity, innovation and tact.

The global financial crisis, the impact of which continues, has itself engendered changes in how projects are being financed. Commercial banks whose long-term lending capacities have been impaired by increased capital adequacy requirements are being replaced at the forefront of most projects by multilateral and export finance lenders, and for stronger projects we have seen the capital markets once again provide a great deal of funding capacity. Changes adopted by the OECD, in part in response to these changed circumstances, have allowed export credit agencies to participate in financing projects in developed economies, with the result that we are now seeing these agencies financing, alongside domestic lenders, major LNG, mining, renewables and transport projects in Australia, the US and Europe. All of this has resulted in truly complex financing where arcane intercreditor and similar arrangements have had to be refined to accommodate ever-increasing numbers of participants.

My career has spanned three decades, encompassing stints in London, New York and Hong Kong, and it has allowed me to act on projects located on six of the seven continents. The scale and complexity of those projects have changed dramatically over that period, with increasingly innovative and intricate finance plans, and with more and more participants drawn from around the globe. As a result, they continue to give rise to novel issues that require customary approaches to be modified to meet new circumstances, and new approaches to be created and implemented. The ultimate judgement call in a project finance transaction is whether a particular risk, and the means available to mitigate it, is "bankable". As long as the markets in which we operate continue to evolve in the face of changing economic, political, technological and social circumstances, helping sponsors and lenders to reach that sort of judgement will continue to be challenging and good fun.