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Middle East IPP Deal of the Year 2003

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Jubail Energy Company (JEC) was a rank outsider for the accolade as being the first Saudi independent power plant (IPP) financing having been dropped by politically risk averse original backers IBJ/Mizuho. But, mandated in February 2003 to Credit Agricole and affiliate Banque Saudi Fransi, the $169 million project debt for the cogeneration plant (otherwise known as the SADAF Cogen project) at the Al-Jubail petrochemicals complex in Saudi Arabia closed just six months later on 16 July.

The speed surprised the market at a time when international relations in the region were at an all-time low. And although an extra $40 million in equity helped move things along, the reform implicit in Saudi Arabia Resolution 169 in 1998 designed to make structuring in the kingdom easier has yet to have a real effect.

Although an inside-the-fence deal, JEC is the first Saudi IPP to reach financial close and sets an unprecedented 15.5-year tenor in Saudi Arabia. Furthermore, the project's structure introduced innovative solutions to common Saudi legal constraints including security on assets, dispute resolution process and treatment of interest under Shariah (Islamic) law.

JEC began in earnest in September 2000 when four consortia - Enelpower; CMS Energy and National Power Company (NPC); Enron and Xenel Industries; and Mitsubishi Corporation - put forward bids for the build-operate-transfer (BOT) project. CMS (25%) and NPC (75%) - a joint venture between Al-Zamil Group and El Seif Group - won the contract in April 2001 with their joint venture SPC Jubail Energy Company.

Under current Saudi law IPPs can only function as captives or sell to industrial zones.

Consequently the project is necessarily an inside-the-fence deal for SADAF (a 50:50 joint venture between Shell Chemicals and Sabic, Saudi Basic Industries Corporation). Saudi Aramco is fuelling the 250MW/510 tonnes/hour steam cogen plant with SADAF offtaking the entire electricity and steam output for its adjacent styrene monomer plant under a 20-year tolling agreement.

The deal has was dogged by global events - syndication officially launched in Bahrain on 12 May 2003, the day following terrorist attacks in Riyadh - and heightened regional risk perception, notably at IBJ/Mizuho which had originally supported the JEC bid. The offering memorandum was circulated to five local and regional banks with a reply deadline of 11 July. Three of the five joined the lead arrangers: Arab National Bank, Riyad Bank (global security agent) and Apicorp.

The JEC Cogen loan is in three parts: a $152 million, 15.5-year term loan priced at 100bp over Libor rising in steps in years six and 12 to 140bp; a $7.5 million standby facility for cost overruns at 110bp; and a $10 million bond. The original IBJ/Mizuho-backed deal incorporated a $60 million equity bridge loan, which was replaced with $40 million equity direct from the sponsors.

The 15.5-year tenor is surprising given the deal is a Saudi first. But, two significant factors gave lenders comfort. First, the tolling contract with SADAF is for 100% offtake. Second, the 20-year term of the tolling contract provides a long tail to the debt - six years-plus.

The main challenge in structuring the transaction was to bridge the requirements of Shariah law governing the project documents and interest repayments with the security needs of a conventional project finance syndicate.

The innovation was a corporate loan that lies dormant and then springs on termination of the power offtake agreement. That loan - pre-signed and owed by SADAF to the project lenders - matches both principal and interest owed in case of default. SADAF is then obliged to repay the corporate loan over a four-year period, thus giving it the flexibility to spread payment of the termination amount. This structure is a departure from most projects where termination payments are usually made in one lump sum.

SADAF agreed to enhance this structure by providing promissory notes, which evidence the deemed indebtedness of the offtaker. These promissory notes were also signed in blank at financial close.

Such arrangements, in many cases precedents, presented legal counsel - Allen & Overy for the arrangers, Linklaters for the counterparty (SADAF), and Shearman & Sterling for the sponsors - with numerous challenges.

For the first time much of the project documentation was done under Saudi law, which allows for the assigning of lenders' rights to the project contracts, but does not allow lenders to register any security over physical assets.

Similarly, a security instrument usually required by lenders in limited recourse financings - a share pledge from the project company - was also impossible since shareholders of a Saudi limited liability company like JEC are not able to waive their pre-emptive rights with respect to the transfer or sale of shares. This issue was addressed through the creation of two intermediate shareholders between the project company and the sponsors - one in Bahrain and another in the Cayman Islands.

JEC is good news for Saudi Arabia and many of its precedents will prove useful for future IPPs - notably Saudi Aramco's BOT package of four cogeneration plants. Saudi Arabia needs IPP development: the kingdom's total installed electricity capacity is around 19,000MW, not including power generated by 25 desalination plants. Of these, nine are dual system plants, which provide 3,214MW excess power per day. With electricity demand, growing at 3.8% annually, required output should reach nearly 60,000MW by 2020.

Jubail Energy Company

Status: closed 16 July 2003

Description: limited recourse financing for first Saudi IPP

Sponsors: CMS; NPC

Counterparty: SADAF

Total project cost: $200 million

Project debt: $169 million

Lead arrangers: Credit Agricole Indosuez; Banque Saudi Fransi

Arrangers: Arab National Bank; Riyad Bank (global security agent); Apicorp

EPC contractor: Siemens

Sponsor counsel: Shearman & Sterling

Lender counsel: Allen & Overy

Counterparty counsel: Linklaters