

Taking the next step

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The Mega Power Project Policy introduces several innovations aimed at resolving issues which have delayed the development of Indian independent power projects. There are some key legal and structuring issues which will need to be successfully addressed by both sponsors and lenders including: offtaker and fuel supplier credit arrangements; fuel supply risk allocation; phasing of large-scale projects; clearances and the regulatory framework; and management of public interest litigation. Though the policy envisages the development of projects in both the private and public sector, this article focuses on private sector projects.

Political environment

To date the ministry of power has given Mega Power Project Policy status to the Hirma coal project in Orissa (3960MW) and has announced tenders for the Pipavav (2000MW) and Cuddalore projects. Delays in the timetable in announcing and awarding tenders have already occurred. As with the development of independent power projects in any other country, the political environment is a key factor in the success of the policy in India. The following factors are perhaps relevant:

? Continued support at the policy decision-making level within the central government is critical. The outcome of the forthcoming elections and the will and attitude of the new government will arguably play an important role in determining the force with which the policy will be actively pursued.

? Much also depends on the success with which (i) the tensions between state governments in whose states where the projects will be located and central government and (ii) the inter-state government relationships power from the projects will be evacuated to more than one state, are resolved.

? A further political constituency, which will need to be considered, comprises those projects not accorded Mega Power Project Policy status ? some opposition to the tax and other incentives accorded to the Mega projects but not to other existing and proposed independent power projects has already been voiced.

Offtaker and fuel supplier credit arrangements

The central innovation of the policy is aimed at addressing the concerns over the lack of the creditworthiness of the State Electricity Boards (SEBs). The requirements of sponsors and lenders alike for central and state government credit support, is the introduction of the Power Trading Corporation (PTC) whose shareholders will include NTPC and financial institutions. PTC will act as the purchaser in bulk buying electricity from the Mega projects. PTC will, in turn, contract with one or more electricity boards for the sale of that electricity and with the Power Grid Corporation for transmission. Credit risk is prima facie therefore transferred from the Mega power project's perspective, from SEBs to the trading company. So the quality of the PTC covenant assumes prime importance.

It is apparent from the Mega Power Project Policy guidelines that central government guarantees supporting PTC are unlikely to be forthcoming. A package of direct and indirect credit support to stand behind both the payment of capacity and energy and also termination payments may be relevant. Some factors will have to be considered:

? The extent to which PTC will be capitalized is unclear but may be insufficient to cover the liabilities under all of the bulk supply power-purchase agreements.

? Initial indications are that PTC will have the benefit of arrangements whereby the obligations of individual electricity boards to PTC under the power-purchase agreements between it and the state electricity companies will be secured by the subvention of the central government's allocation of central funds to the relevant state government. Under these arrangements, if a state electricity company fails to pay the trading company, the monies from central government standing to the credit of the state government's account with the Reserve Bank of India would be secured in favour of PTC. It appears that the projects will not be a party to these arrangements. An obvious solution is for that security to be assigned to the project or perhaps of more relevance, the project's lenders.

? Given the recent controversies surrounding escrow cover and the practicalities of implementing escrow arrangements where there are multi-state purchasers, short term liquidity support required by projects is likely to be in the form of letters of credit. Issuing banks will need comfort from PTC or its shareholders as to reimbursement.

The arrangements between PTC and PGC will need to be reviewed to ensure that delays in the construction of or failures in the operation of transmission facilities are adequately compensated and that the benefit of that compensation flows through under the bulk power purchase arrangements. The credit standing of PGC will therefore be a relevant consideration.

The security likely to be required by fuel suppliers, with long-term contracts, may well be a relevant structuring consideration, especially given the scale and size of the projects contemplated. A recent project has successfully addressed this issue by establishing contractual and trustee arrangements whereby the fuel supplier has access, ahead of the project lenders, to the energy payments due by the power purchasers to the project company. In that case the payments flow directly from the escrow arrangement established by the project company over a specified part of the power purchaser's receivables. Given the historical development of the independent power sector in India, the structuring of a financeable credit support package is probably the central issue which will determine the success or failure of the Mega Power Project Policy.

Fuel supply risk allocation

The potential sources of long term fuel supplies for the Mega projects are principally coal and liquefied natural gas (LNG). The general perception in the industry seems to be that naphtha and liquid fuels are likely to be used principally as stand-by fuels. Traditionally LNG sales have not been non-recourse or limited recourse financed projects. The Dabhol project (see page 12), which is sourcing its LNG supply from Oman and Abu Dhabi, marks a significant step in the development of contractual arrangements ? in the context of the risk allocation between upstream and downstream contractual arrangements.

Given the development of power-purchase agreements in India, a likely area of difficulty between the project company and PTC is that of the allocation of the risks associated with the availability of fuel or the failure to take fuel. The issues are complex and require detailed negotiation but perhaps an example is worth considering. For LNG-based projects an important tension for the project company is the take-or-pay obligations it will face under its LNG sale and purchase agreement and its ability to cover this risk under its arrangements with PTC. The issues are relatively clear where there is a failure to dispatch for non-force majeure reasons ? the risk is usually borne by the purchaser. However, if there is a force majeure affecting transmission facilities (owned by a third party) it may well be the case that the (traditional) LNG sale and purchase agreement does not provide force majeure relief to the project company whereas the force majeure provisions in the power-purchase agreement will relieve the power purchaser. How should this risk be allocated?

The issues surrounding the requirements of fuel suppliers, especially in respect of imported fuel ? and the integration of the upstream and downstream arrangements to provide a risk allocation that is acceptable to lenders, the project

company and the power purchaser, will pose important contractual issues for the Mega power projects.

The size and scale of the proposed projects and their substantial capital costs and financing requirements may require that they be constructed and financed in separate phases. Phasing any independent power project in India or elsewhere requires a contractual framework which minimizes the impact of a number of commercial, financing, regulatory and political issues:

? It is important to minimize the need for fresh negotiations on commercial points with project counterparties and lenders at each phase. This is particularly the case where project documents require approval by governmental agencies.

? It is essential that applicable clearances acknowledge and provide for phasing at the time the clearances are granted.

? Different sources and combinations of financing are likely to be used for each phase. Lenders to each phase may well have differing requirements, particularly in the context of security sharing. Issues of Indian law regarding the sharing of the security package in particular will need to be addressed.

As demonstrated by the Dabhol project, if the appropriate considerations are accounted for at the structuring stage, it should be possible to implement the project in manageable pieces.

Clearances and the regulatory framework

The clearances which need to be obtained to develop an independent power project in India fall into three broad categories;

? Those needed for the establishment of a project ? essentially Foreign Investment Promotion Board (for equity investment by non-residents) ? Central Electricity Authority and others required under the Electricity (Supply) Act, 1948;

? Project specific clearances for construction and operation;

? Clearances for financing and security purposes, notably from the ministry of finance and the Reserve Bank of India. These clearances need to be considered in the context of external commercial borrowings and also in structuring the lending and security package.

It is likely that export credit agencies and multilateral agencies in particular will need to be satisfied that there has been full compliance with (i) the rehabilitation and resettlement requirements as per the World Bank guidelines and (ii) all environmental legislative requirements.

The Mega Power Project Policy guidelines indicate that at the time a project is awarded all requisite clearances will be made available. This carries echoes of the single window clearance approach adopted at the time of the introduction of the private sector participation policy in 1991. In reality the clearances required were significantly more extensive than those set out by the ministry of power. The importance of the clearance process should not be underestimated, but how these will impact on any particular Mega project or the policy itself remains to be seen.

Public interest litigation

Various independent power projects in India have, over the past few years, faced litigation, some of which has led to significant delays. Many of the challenges have been framed under the vehicle of public interest litigation. The likely high profile of the Mega projects may well attract litigation.

Under the constitution of India every Indian citizen has the right to commence, a public interest litigation to seek relief by way of judicial review of any decision made by the central government or other person in authority. While many litigants bring a claim because they are genuinely aggrieved and have the interests of the public at heart, it is not unknown for

public interest litigation actions to be covertly supported by rival political organizations.

The right to bring public interest litigation proceedings is widely framed. Actions have, for example, been based on: claims that required clearances were not obtained or were improperly granted; environmental clearances and claims that state or central government support granted to a project is unconstitutional.

A recent decision by the Supreme Court of India, the implications of which are still being considered, may however reduce the likelihood of a public interest litigation being filed against a Mega project. That decision provides effectively that a petitioner seeking an injunction against a project must put up as security the likely costs incurred by the project while the matter is determined by the court.

However, it is important for a project to manage, to the extent it is able, the risk of losing a public interest litigation proceeding. While there is little that can realistically be done to prevent the filing of a public interest litigation, proactive steps to manage the potential consequences include:

? Ensuring, through obtaining all required clearances, that the petitioner and in turn the court has no legal basis on which to found a legally valid claim. The courts will not generally interfere with a policy decision made by a governmental agency unless it is apparent that the proper statutory procedures have not been followed;

? Formulating and implementing a soundly based public relations campaign addressing the likely concerns of interested persons;

? Managing the genuine concerns of the local population most likely to be affected by the project.

The Mega Power Project Policy represents a bold initiative on the part of the government of India to address the problems which have beset the development of private sector participation in the power sector. The decision to open the process of awarding projects on a competitive bid basis is hopefully likely to address the question of transparency which has been raised in the context of other projects. It is clear that a number of key structuring issues will need to be closely considered and resolved if the projects are to succeed.

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