THE PROJECT FINANCE LAW REVIEW

Editor
David F Asmus

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CONTENTS

PREFACE

Many of the classic project finance texts are becoming increasingly dated as the years go by, while project finance itself continues to evolve with the markets it serves. The purpose of this volume is to provide a living guide to project finance that will be updated on a regular basis, while still tackling the core project finance concepts that every practitioner needs to understand.

As the inaugural addition, this volume seeks to cover the most salient topics while leaving scope for expansion into other key areas (such as mezzanine financing, government funding, and social and environmental issues) in the second edition. As discussed briefly at the end of chapter 1, all three of these areas have been in great flux, with newer funding sources (e.g., private equity), changes in the bond insurance market and more substantial environmental restrictions in effect at key lending institutions (particularly with respect to climate change concerns) all combining to change the complexion of the project finance market. The next several years should bring more clarity to all of these subjects, including particularly the future of project finance in the large oil and gas industry.

I would like to express my thanks to all of the authors of this inaugural edition. It is never easy to be a pioneer, which in this case entailed late nights drafting chapters from scratch for a new publication. Our authors have executed this task with distinction and aplomb. It is the hope of all of the authors that this volume not only will be of use to all of its readers today, but will also continue to grow in scope and utility in the years ahead.

David F Asmus
Sidley Austin LLP
Houston
April 2019

Chapter 8

LENDER RELATIONSHIP WITH PROJECT COUNTERPARTIES

David Armstrong and Gregory Howling[1]

I INTRODUCTION TO PROJECT AGREEMENTS

Central to any project financing are the project agreements or project documents – the contractual arrangements of the borrower for the development, construction, operation and maintenance of the underlying project. Depending on the status and type of the project, project agreements may include construction contracts, supply agreements, operation and maintenance agreements and offtake agreements, among others. It is imperative for lenders to understand, evaluate and preserve the project agreements because (1) they are the primary components of the project's value throughout the life of the project; (2) they form the basis for credit extensions under the credit facility (whether during construction in the form of construction loans and letters of credit to support the borrower's performance obligations under the project agreements or during operation in the form of working capital loans and letters of credit for similar support); and (3) lenders receive a security interest in them as part of the non-recourse financing structure.

Unlike other secured lending transactions, the value in a project financing is the revenue stream from the project more so than the value of the physical assets themselves. To a lender, maintaining the project as a going concern, and therefore maintaining the contractual rights and relationships that allow the project to be built (on time and on budget) and to operate, both during the term of the facility and in the event of foreclosure, is a key element of any transaction.

Further, the obligations of the borrower under the project agreements create the basis for certain credit facilities and extensions. For example, under many project agreements, since the borrower is not an otherwise creditworthy entity, the borrower may be required to provide performance security to its counterparties. In lieu of providing cash security, the borrower will look to lenders for a letter of credit facility pursuant to which lenders will issue required letters of credit to the project counterparties as beneficiaries thereunder. For projects under construction, the construction contracts will contain key milestones and conditions to payments and, by extension, draws under the credit facility. Consequently, it is important for lenders to understand the terms of such project agreements and ensure that such agreements are not amended or otherwise modified, including through change orders during construction, without their consent.

Given the importance of timely construction of the project (on budget and in accordance with the performance parameters established in the underlying construction contract), the project's continued operation, and the non-recourse nature of project financings, lenders

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typically require a grant of a security interest in all project contracts of the borrower as part of the collateral package. As a result, in the event of a foreclosure on the assets of the borrower, lenders (though their agent or another designee) are able to take assignment of project agreements. For that assignment upon foreclosure to be effective in practice, lenders must understand whether the project agreements permit such assignment and, most importantly in the cases of material agreements, they must seek contractual privity with counterparties to receive those counterparties' prior consent to any foreclosure action and to negotiate any interim rights for the lenders (or their agent or another designee) to step in and cure defaults prior to exercising the last-ditch option to foreclose.

For lenders, evaluating and preserving the project agreement structure and mitigating possible risks associated therewith is addressed through due diligence, the finance documents with the borrower and, in many cases, with direct agreements with the applicable project counterparties. These are not mutually exclusive options and lenders do, and should, use them in combination with each other.

II UNDERSTANDING AND EVALUATING THE PROJECT STRUCTURE THROUGH DUE DILIGENCE

The first step in any project financing is due diligence of the borrower and the project, including understanding and evaluating the project agreements and project counterparties. Due diligence, even with respect to project agreements, is a multifaceted process. Through consultants, counsel and internal experts, lenders will evaluate market risk, construction risk, operational risk and contractual risk, among others. In each facet of diligence, the analysis will inevitably turn to the project agreements and the risks thereunder, risks that relate to non-performance of both the borrower and the counterparty. Similarly, in transactions where project agreements form a basis for part or all of the credit facility, such as facilities under which letters of credit will be issued or where payment obligations under construction contracts require draws by the borrower, lenders should evaluate the circumstances, timing and likelihood, of draws on the applicable loans or letters of credit.

While diligence allows lenders to understand the overall picture of project agreements applicable to the project, it also, importantly, allows lenders to determine what project agreements are material. In evaluating materiality, lenders typically look at a given contract's impact on the construction of the project, the projected performance of the project, the revenue stream of the project during operation (i.e., the financial impact of a termination or other impairment of the applicable project agreement) and the replaceability of the contract (i.e., in the case of a supply or an offtake agreement, the presence of a robust spot or merchant market, or more generally, the willingness of other creditworthy counterparties to enter into replacement contracts on similar terms). Essentially, if the borrower's contractual rights under a particular project agreement are necessary for the timely and cost-effective construction of the project, the operation of the project in accordance with applicable law or the maintenance of the revenue stream of the project, and the project agreement cannot quickly and readily be replaced with a comparable contract, that project agreement will be considered a material contract. As a practical matter, material contracts are likely to include key construction contracts, offtake agreements, interconnection agreements (if applicable), operations and maintenance agreements and services agreements. As will be discussed in further detail below, the designation of a contract as material will generally result in the application of specific conditions, covenants and events of default under the financing documents and in a requirement that such contract be subject to a direct agreement with the lenders (or their agent).

While there are basic elements of diligence applicable to every project, the rights of lenders during the diligence phase to mitigate risks and how information gathered during the diligence phase is used is heavily dependent on the status of the project (i.e., whether it is yet to be constructed or is in operation).

For a construction project, the legal due diligence phase for a project financing will often consist of reviewing advanced drafts of, rather than executed and effective, project agreements. With the agreements still subject to negotiation between the borrower and its counterparties, lenders can identify red flag risks under the draft agreements and work with the borrower to mitigate those risks through changes before execution. Those changes may include, for example, modifying counterparty termination rights, increasing counterparty performance security obligations or agreeing to a form of direct agreement. In the event that those changes are not accepted, or the applicable project agreement has already been executed, the lenders may still address such points through the terms of the loan agreement, namely the covenant package, and the direct agreement with the counterparties (in which modifications to the applicable contract can sometimes be agreed, rather than through an independent amendment).

In financings for operating projects (or projects nearing operation), the project agreements have typically been fully negotiated and executed. As such, there is limited ability for lenders to request changes to any particular project agreement (though, in the case of a fatal flaw, lenders may still require modifications to a contract). Instead, the primary risk mitigant for lenders for an operational or near-operational project is through the covenant package and the direct agreement.

Due diligence, whether on a to-be-developed or an already developed project, allows lenders to identify and evaluate the project agreements and the potential risks resulting therefrom. And, most importantly, with this knowledge, it shapes the terms of the financing documents, including provisions in the credit agreement such as the representations, conditions precedent, covenants and events of default, as well as the terms of the direct agreements and from whom such direct agreements shall be required. Such due diligence may also result in requirements for sponsor credit support to address certain risks in the project agreements that cannot be addressed through such provisions and direct agreements.

III PRESERVING THE PROJECT AGREEMENT STRUCTURE THROUGH CREDIT AGREEMENT PROVISIONS

A broad understanding of the project agreements, including what are and are not material project agreements and the risks thereof, as achieved through diligence, primarily impacts four key sets of provisions of a credit agreement in any project financing: the representations and warranties, the conditions precedent, the covenants and the events of default.

i Representations and warranties

Through the representations and warranties, lenders seek to receive factual statements about the project agreements and the performance of the borrower and counterparty thereunder. Typical representations and warranties with respect to project agreements include a list of all agreements to which the borrower is a party, a statement that all project agreements are in full force and effect and there are no other project agreements than those that have been provided to the lenders, a representation that, to the borrower's knowledge, the counterparties' representations and warranties in the underlying project agreements are true and correct, a representation that all information provided by the borrower to the lenders' third party consultants is true and accurate in all material respects, and that there is no default or other adverse events (such as force majeure) under the project agreements. Lenders will also seek a representation from the borrower that the financing will not contravene or result in a lien under the project agreements.

While the inclusion of representations and warranties covering the above matters is standard, there are still significant points of negotiation between lenders and the borrower. In a perfect world from a lender's perspective, all representations could be given as 'clean' representations – that is, the representations would not be subject to any qualifications. However, particularly in the case of representations that speak to the actions or statuses of other parties, borrowers resist giving them without qualification. In the case of representations relating to project counterparties, the parties often agree to limit the representations as to the status or actions of counterparties to the extent the borrower has knowledge of such facts. However, to the extent that a representation pertaining to a project agreement is within a borrower's control – for example, a statement that the borrower is not in default under a given project contract – lenders should resist any attempt to include a knowledge qualifier. Further, borrowers will negotiate thresholds for representations requiring the listing of project contracts and may also seek to limit non-contravention and no lien representations to only the agreed material project agreements. Finally, borrowers will seek to subject their representations to a materiality qualifier. This qualifier can take the form of general materiality (e.g., that there are no material breaches under the project agreements) or material adverse effect (MAE). While MAE is an often heavily negotiated concept, at its most basic level, an MAE qualifier means that the representation is true and correct except for non-disclosed items that do not have a significant impact on the operations of the project or borrower. As such, MAE is a much higher standard than general materiality and lenders are resistant to its liberal use in representations, particularly with respect to important project agreements.

Representations and warranties for project agreements serve several purposes. First, they act as a confirmation of diligence. The list of project agreements proposed by the borrower (typically attached as a schedule to the credit agreement) should confirm the lenders' understanding of the complete contractual arrangements for the project and, in instances where there are discrepancies, allow lenders to conduct diligence on any newly disclosed contracts prior to execution of the financing documents. Second, accuracy in all material respects of representations and warranties is typically a condition to the effectiveness of the credit agreement and to each extension of credit thereunder. Finally, as discussed more below, a breach of a representation (occasionally subject to a cure period) in any material respect is universally an event of default under a credit agreement.

ii Conditions precedent

The conditions precedent to a credit agreement provide another opportunity for lenders to address risks associated with project agreements. Conditions precedent are actions or events that must occur prior to the effectiveness of a lender's (or other creditor's) obligations to extend credit under the applicable debt documents. Typically, there are several customary conditions precedent in respect of project agreements that the parties will expect to include in the credit agreement. These conditions include, among others: the execution and delivery of direct agreements with specified counterparties and delivery of any legal opinions required thereunder, receipt by lenders of all validly authorised and executed project agreements (which such project agreements must be in a form satisfactory to lenders), a requirement that the project agreements are in full force and effect without any undisclosed amendments, and compliance with and no default under the project agreements by the borrower and the counterparties thereto. Additionally, as mentioned, lenders will expect the borrower to certify that all representations and warranties (including those related to the project agreements and counterparties) are true and correct in all material respects.

The intent of these customary conditions precedent is fundamentally to ensure the lenders' comfort and satisfaction with the form and status of the project agreements, and with the borrower's and its counterparties' performance thereunder. Further, lenders seek to ensure that all documentation with respect to the relationship between lenders and project counterparties is in full force and effect and has been provided to the lenders – in other words, the lenders want certainty that all important project agreements were provided to them during the diligence process and that the lenders have any required rights (through a direct agreement) under material project agreements. In each case, lenders want to establish a satisfactory system prior to incurring exposure to the borrower.

In addition to the above, lenders may also seek bespoke conditions precedent (e.g., delivery of certain amendments of or additional credit support by the counterparty under a project agreement). These conditions precedent will be developed in the course of diligence and will address risks specific to the project or its project agreement that lenders deem unacceptable, and so must be addressed prior to the effectiveness of any project financing.

iii Covenants

Having evaluated the project agreements through diligence (and negotiated the corresponding representations and warranties) and established acceptable conditions precedent for funding, lenders turn to the covenant package of the debt documents to preserve the project agreements arrangement during the term of the financing. Project agreements are addressed in both the affirmative covenants and negative covenants found in any project finance credit agreement.

Affirmative covenants

Through affirmative covenants, lenders seek to require the borrower to take specific actions in respect of the project agreements. In the information covenants (a subcategory of the affirmative covenants), the borrower will be required to deliver to lenders certain notices or other correspondence received or delivered by the borrower in respect of the project agreements. Such notices include: notices of default or breach under the project agreements, notices of force majeure or other material events (such as casualty or condemnation events), and notices of any action or threat of action against a material project counterparty. In some cases, especially in transactions involving new technology or where greater oversight is needed, lenders may also require borrowers to provide lenders with copies of all correspondence outside the ordinary course of business under the project agreements. In all cases, these information covenants allow lenders to remain promptly informed of any material developments at the project.

In addition to the delivery of notices and related information, the affirmative covenants commonly include a requirement that the borrower comply with its obligations under the project agreements. Further, if the borrower enters into any additional or replacement project agreements, the borrower will be required to take all such actions necessary to ensure that such agreements become subject to the lenders' security interest.

Finally, the affirmative covenants may also include covenants specific to the project's status and nature of the financing. For example, if a key project agreement expires prior to the maturity of the debt facility, lenders may require the borrower to exercise any extension options under the agreement or otherwise enter into a replacement agreement with terms and a counterparty acceptable to the lenders.

Negative covenants

In respect of the project agreements, the most important covenants are the negative covenants. Generally speaking, these negative covenants prevent the borrower from taking, without lender consent, certain actions that would otherwise disrupt or materially alter the basis upon which the lenders lent to the project. Central to this protection is the covenant against termination of, or material amendment to, the project agreements, which restricts (subject to exceptions and materiality qualifiers) the borrower from terminating, amending or modifying a project agreement. This covenant also typically restricts the borrower's ability to assign or permit a counterparty to assign its rights under a project agreement. Finally, it is common for the covenant to prohibit the borrower from granting any consent or waiver in respect of a material obligation under a project agreement. For a project under construction, this covenant will generally also prevent material change orders under any construction agreement, so that changes to the construction schedule or cost (which function like amendments to the main construction contract) are subject to lender approval. This covenant is generally subject to three qualifiers.

First, it will only apply to those project agreements that were agreed as material. Second, borrowers often negotiate replacement rights. These replacement rights usually permit some time period during which the borrower, without breaching the covenant, can enter into an acceptable replacement contract (with an acceptable counterparty) if the original contract is terminated early. The lenders and the borrower may even pre-agree to a form of acceptable replacement contract that is attached to the credit agreement, or that must contain certain terms that are addressed in a schedule to the credit agreement. The replacement rights can be conditioned on the borrower executing a replacement agreement with a specified counterparty, a counterparty with specified levels of technical expertise and creditworthiness, or one that is otherwise acceptable to lenders. Third, the covenant generally prohibits only actions that would have a materially adverse effect on the borrower, with the extent and nature of that materiality qualifier often varying according to the overall importance of the underlying project agreement.

As indicated above, the qualifiers and the covenant generally often do not equally apply to all material project agreements. For instance, in the case of particularly important project agreements, the borrower may not be permitted to replace the agreement. Further, in the case of such an agreement, the lender consent threshold may be a super majority, instead of a simple majority consent, or the material adverse effect qualifier would not apply (such that lenders get a say over any amendment to or waiver under such contract, however important).

There are two additional negative covenants generally applicable to project agreements in a project financing. First, there is a prohibition on settling or compromising any material claim against a project party. This covenant is generally qualified by materiality, in that the project party has to be a material project party (e.g., construction contractor, offtaker or material service provider). Second, the negative covenants typically include a covenant that prohibits the borrower from entering into any new project agreements involving new project expenditures. As with the other negative covenants, this covenant is also commonly subject to certain exceptions. In this case, the borrower will negotiate agreed individual and aggregate thresholds for contract expenditures before the covenant is applicable or, if such expenditures exceed those thresholds, a material adverse effect qualifier. The parties can also negotiate the term for any new contract under which these expenditures are incurred that must elapse before the covenant is triggered – for example, the parties may decide that new expenditures governed by a contract with a term of less than a year are sufficiently immaterial to avoid running afoul of the covenant.

As with the other credit agreement provisions, the lenders may also require additional negative covenants based on project-specific material issues (e.g., a prohibition on the borrower materially amending credit support received from counterparties).

Events of default

The last section in a credit agreement that involves the project agreements is the event of default provisions. There are several standard events of default that implicate the project agreements or project counterparties.

First, there is a breach by the borrower of a representation: this event of default is most commonly subject to a materiality qualifier (i.e., the applicable representation is breached in any material respect) and in some cases a cure period. Second, there is a breach by the borrower of a covenant in the credit agreement. Depending on the covenant, the borrower may be granted a period to cure the breach – though as matter of practice, since they are entirely within the control of the borrower, negative covenants are not subject to cure periods. In the case of affirmative covenants applicable to the project agreements, the borrower is almost always granted a cure right.

Third, there is a default by the borrower or a specified project agreement counterparty under a project agreement or direct agreement, or the failure of any such project agreement or direct agreement to be in full force and effect. In this case, the event of default is typically limited to material project counterparties. Further, the borrower often has a cure right for defaults or breaches of material project agreements by the applicable counterparties. This cure right, which allows the borrower an agreed period of time to pursue remedies against the defaulting counterparty, may be subject to additional qualifiers such as maintaining a certain financial covenant, funding any shortfalls in reserve accounts or unreimbursed letter of credit drawings and certifying to no other defaults or events of default under the credit agreement.

The final relevant event of default is an insolvency event of a specified project counterparty (e.g., the counterparty voluntarily or involuntarily files for bankruptcy). The counterparties implicated by this standard event of default are often the offtaker, the operator of the project and, in the case of a project under construction, the main construction contractor. However, this list may vary depending on the nature of the contractual arrangements of the project. Unlike the bankruptcy of the borrower, or any pledgors or guarantors (which results in an immediate event of default), typically, there is an agreed period of time after the project counterparty experiences the insolvency event before a default occurs under the credit agreement, and, often, the counterparty's continuing performance of its obligations under the underlying project agreement during the bankruptcy may prevent the occurrence of the event of default. Further, the borrower is often granted a replacement right to replace the insolvent project counterparty. As with the cure right for project agreement defaults, the borrower often must meet additional qualifiers similarly to those detailed above to benefit from the replacement right.

The events of default described herein as well as the other credit agreement provisions discussed above reflect how central the project agreement structure and the prompt performance by all project counterparties and the borrower of the terms thereunder are to a financing. As noted above, lenders seek to use the credit agreement to ensure the borrower preserves this structure, as it forms the basis upon which the lender is extending credit, while at the same time granting the borrower reasonable flexibility to satisfactorily replace or cure problematic project agreements and counterparties. If the structure or performance of obligations drastically changes, lenders use the credit agreement provisions to prevent further exposure to the borrower.

IV ESTABLISHING CONTRACTUAL PRIVITY THROUGH DIRECT AGREEMENTS

The final tool that lenders have available to preserve the project agreement structure, and to gain contractual privity with a project counterparty, is a direct agreement. The direct agreement, which is often referred to as a 'Consent' in US-based project financings, is a financing document between the lenders (acting through the collateral agent, who is appointed to enforce the lenders' security interest at their direction), borrower and the project counterparty. It is often considered the most important element of any project financing, particularly with respect to the most significant project agreements. As with credit agreement provisions applicable to project agreements, lenders and the borrower will negotiate the universe of counterparties from whom direct agreements will be required. Given the importance of direct agreements in ensuring that project agreements remain in force and the security interest granted in them remains valid, lenders will at the very least require them from the standard material project counterparties.

As a primary matter, direct agreements are a consent to the collateral assignment of the project agreement. Under the terms of the direct agreement, the project counterparty is consenting to the security interest in the borrower's rights to the project agreement that the borrower has granted to the lenders under the security agreement (or other collateral instrument). Even with respect to project agreements that by their terms expressly permit collateral assignment, lenders will request a direct agreement that includes the express consent to assignment. To that end, they are a collateral document and will benefit from the provisions of the credit agreement as such.

In addition to consenting to the grant of the security interest, the direct agreement also provides the lender with certain rights in respect of the project agreement vis-à-vis the borrower and the project counterparty. A direct agreement will often require the counterparty to concurrently deliver to the lenders copies of notices sent to the borrower. Additionally, a standard direct agreement will grant lenders the right to cure any breach under the project agreement by the borrower. Cure rights are essential in any direct agreement because they ensure that the lenders do not lose the benefit of the underlying project agreement without the opportunity to fix the problems. Such cure rights are often subject to agreed time periods – note that the lenders will usually have a shorter time to cure defaults arising from the borrower's failure to make a payment owed under the project contract than to cure those arising for other reasons. The cure rights in a direct agreement are often heavily negotiated with each project counterparty, with a counterparty typically taking the view that it has already negotiated appropriate cure periods with the borrower. To avoid some of this negotiation, a seasoned and sophisticated borrower will often look to negotiate a form of direct agreement as part of the negotiation of the underlying project agreement. This is the time when a borrower has the most leverage over its counterparty and, assuming it understands the needs of its lenders, can make the negotiation of the direct agreement far smoother.

Further, as with the covenants applicable to the borrower in the credit agreement, in the direct agreement, the counterparty itself will be asked to agree to refrain from terminating, assigning or materially amending the applicable project agreement without lender consent. This way, the lenders have recourse directly against the counterparty, since the corresponding credit agreement covenant will only be enforceable with respect to the borrower. This provision is often resisted by project counterparties, particularly if a form of direct agreement has not been pre-negotiated. As part of the give and take of the negotiation, lenders will often live without the portion of the provision preventing the counterparty from amending the project agreement, and will rely on its covenants on the borrower in the credit agreement.

Under a direct agreement, lenders will also seek to receive the project counterparty's pre-agreed recognition of lender enforcement rights. Under the step-in rights and substitute owner provisions, lenders (or their agent or other nominees) are granted the right to temporarily or permanently step into, and perform, the borrower's rights and obligations under the project agreement. The substitute owner provision will also, in the event of a foreclosure by the lenders, permit the applicable purchaser in a resulting foreclosure sale to be recognised as the successor to the borrower and perform under the contract. These provisions are typically highly negotiated as project counterparties seek to mitigate the risk of unqualified substitute owners while lenders seek to preserve a broader market of potential buyers in a foreclosure. In consideration for the recognition of a substitute owner (other than the collateral agent as an interim owner), the project counterparty may seek specific parameters applicable to the proposed substitute owner. For example, the project counterparty may request certain creditworthiness and expertise standards, ensuring that the ultimate substitute owner is reasonably capable of operating the project and meeting the obligations under the project agreement. Additionally, as a condition to recognising a substitute owner or permitting lender step-in rights, the project counterparty will frequently negotiate the direct agreement to require the lenders to cure any existing borrower defaults under the project agreement.

Similarly, if the agreement is terminated as a result of the borrower's insolvency, the direct agreement's replacement provision will require the counterparty to enter into a new project agreement with the collateral agent (or a nominee thereof). This provision will customarily require that the replacement agreement be on substantially the same terms as the existing project agreement. The object of this provision and the provisions related to substitute owners is to preserve the value of the project as a going concern in the event of foreclosure.

The direct agreement will also require the project counterparty to deposit any payments under the direct agreement into the secured accounts established pursuant to depositary or accounts agreement for the financing.

Replicating provisions found in the credit agreement, the direct agreement also contains representations and warranties from the applicable project counterparty for the lenders' benefit as to the counterparty's status and the status of the project agreements –as discussed above, the borrower can usually only make qualified representations as to the counterparty's status and performance. Further, the direct agreement will occasionally contain a covenant requiring the counterparty to continue to perform its obligations under the project agreement, although this covenant is often heavily resisted by the counterparty on the basis that it overrides many of the other negotiated provisions of the direct agreement. Finally, lenders may also request that the project counterparty's counsel deliver a legal opinion as to the enforceability of the direct agreement against the counterparty. This requirement is often a point of contention, as project counterparties resist the incurrence of additional expense (though lenders may accept an in-house counsel's legal opinion to assuage this concern) and liability attendant with delivering a legal opinion.

While the requested elements of direct agreements are standard, and direct agreements are often treated as secondary documents in the course of financing negotiations, their importance cannot be overstated. Without a direct agreement, lenders would not have an agreement with the project counterparties that they can enforce, and thus are exposed to potential significant risk that the project agreement structure would not remain in place following foreclosure or default by the borrower. Direct agreements are often heavily negotiated, and some counterparties, particularly those that are experienced in project finance and knowledgeable as to what has been accepted in other transactions, have great success in pushing back against the standard provisions in a direct agreement. As noted above, to ensure a smooth and efficient execution of a project financing, a borrower is well advised to pre-negotiate the requirements of a direct agreement with its project counterparties.

V CONCLUSION

With the value of the asset, and therefore the lender's security package, being derived substantially from the successful construction and ongoing operation of the project, project agreements and counterparties – not to mention the borrower's and lenders' relationship thereto – are the key elements to any project financing. To fully understand and mitigate the risks of, and to, the project agreement structure, it is imperative that lenders thoroughly carry out due diligence on the project agreements, negotiate key credit agreement provisions (in particular conditions precedent and covenants related thereto) and enter into comprehensive direct agreements. Without this holistic approach, lenders face considerable risk of degradation in asset value during the term of the loan and in the event of any foreclosure or subsequent sale.

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