Introduction to BOT

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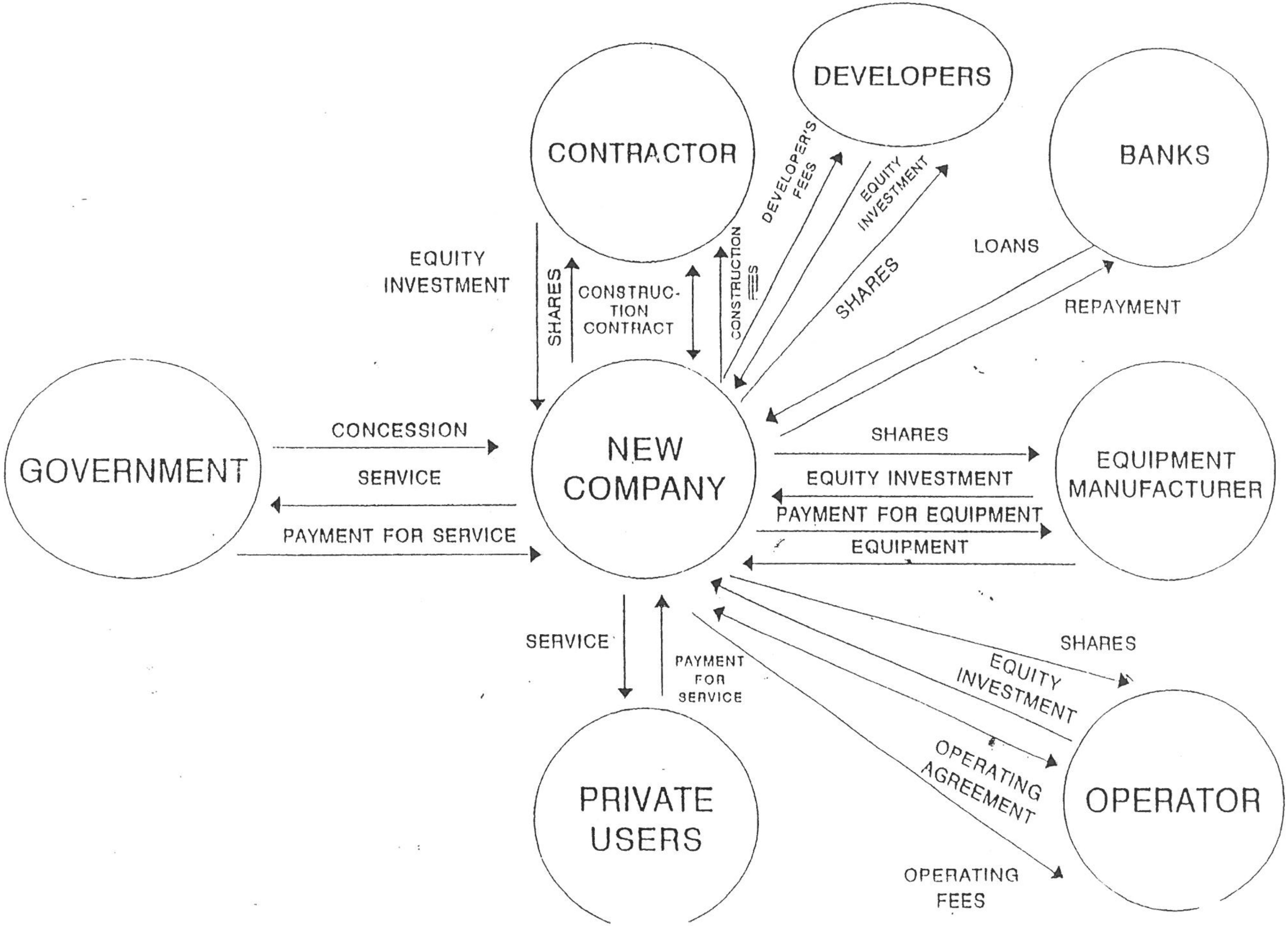
"BOT" TRANSACTION



BUILD OPERATE TRANSFER ("BOT") TRANSACTIONS

I. INTRODUCTION

A. Project Finance. The term "project finance" refers to a type of non-recourse or limited recourse debt financing where the debt is largely a claim against the cash flows or payment stream from a particular project rather than against an entity's entire assets.

In other words, the GOVERNMENT and the investors/lenders can look only to the project to repay their loans, not the sponsor's other assets.

B. Overview of the Build Operate and Transfer ("BOT") or Concession Financing Transaction.

1. The Build, Operate and Transfer or "BOT" deal. "BOT" is essentially a type of project finance whereby the GOVERNMENT grants a CONCESSION to a private entity (the "PROJECT COMPANY") to build and operate a project, such as infrastructure or resource extraction, that would usually be operated by the GOVERNMENT. After a period of time, the project is transferred to the GOVERNMENT.

2. CONCESSION. The CONCESSION is essentially a grant of a franchise by the GOVERNMENT to the PROJECT COMPANY of the GOVERNMENT'S monopoly power to build a project.

a. Typical BOT projects include:

(1) infrastructure (ports, airports, roads, railways, bridges, tunnels);

(2) public utilities; and

(3) resource extraction.

b. Infrastructure projects, in particular, share a number of characteristics which set them apart when viewed as financing propositions. These characteristics include:

c. roadway users travel more quickly and safely (provided of course that the GOVERNMENT retains sufficient control over the charges such that the PROJECT COMPANY may not raise tolls to an amount that will cause the road to be unusable by a large percentage of the population).

7. Keys to Success.

a. A central characteristic of a successful BOT deal is that all parties believe they are getting a good deal, despite their very often different objectives.

b. It has also been suggested that deals--such as private power deals--require, above all else, a "local hero"; that is, some senior individual in government who wants privatization to happen, who knows how to cut through the red tape, who can take on those who are determined to keep the status quo.

C. Distinguishing ~~then~~ "BOT" from the "BOO" Transaction.

1. Unlike BOT where the PROJECT COMPANY turns the project back to the GOVERNMENT after the CONCESSION PERIOD, the Build, Operate, Own or "BOO" deal represents full privatization because the PROJECT COMPANY does not turn the project back to state control after a CONCESSION PERIOD.

2. Many investors prefer BOO because it reflects a more determined emphasis on permanent privatization.

I. INTRODUCTION TO THE CAST. The list of cast members described below attempts to capture the parties that might be involved in a "BOT" privatization structure. Of course, each "play" is different and will not necessarily involve all members of the cast. For example, with an infrastructure project such as a road the tolls will be paid by the private users and there may not be any contractual offtakers. Likewise, in the case of a power plant, there may only be contractual offtakers and no private users.

A. Government. The GOVERNMENT will enter into a CONCESSION AGREEMENT with the PROJECT COMPANY.

B. PROJECT COMPANY. The PROJECT COMPANY is the new company that will be created to build and operate the project during the CONCESSION PERIOD. It will be the other party to the CONCESSION AGREEMENT.

C. CONTRACTOR. The CONTRACTOR will often be a significant equity participant in the PROJECT COMPANY.

1. That is, it will contribute seed capital in exchange for an equity interest.

2. The CONTRACTOR will enter into a CONSTRUCTION CONTRACT with the PROJECT COMPANY.

D. COMMERCIAL BANK(S). The BANKS will provide the financing for the construction of the project.

1. Most often this will actually be a syndicate of banks led by one or two "Agents" for the others, which will do most of the negotiation.

2. The BANK debt will be serviced from the revenues generated from the project. The BANKS will enter into a Credit Agreement with the PROJECT COMPANY.

3. In some instances--such as Orlyval, the light rail link between Central Paris and Orly airport in France, and the English Channel Tunnel-- the BANKS may also be equity participants in the PROJECT COMPANY.

E. EQUIPMENT MANUFACTURER AND SUPPLIER.

1. The EQUIPMENT MANUFACTURER and SUPPLIER will enter into supply agreements with the PROJECT COMPANY.

2. These parties may also be equity participants in the PROJECT COMPANY.

F. PRIVATE USERS/CONTRACTUAL OFFTAKERS.

1. The private users are those who will ultimately make use of the project and pay the revenues.

2. The private users will either receive the service directly from the PROJECT COMPANY or indirectly through the GOVERNMENT, depending on whether the PROJECT COMPANY is permitted to sell directly to PRIVATE USERS or whether it must

sell all of its product to the GOVERNMENT or other CONTRACTUAL OFFTAKER which will then sell to PRIVATE USERS.

3. The principal concern of the PRIVATE USERS will be their ability to afford and thus use the project.

G. OPERATOR.

1. If the PROJECT COMPANY or the CONTRACTOR is not also the OPERATOR, the PROJECT COMPANY will enter into an OPERATING AGREEMENT with the OPERATOR. The OPERATOR will operate the project during the CONCESSION PERIOD in exchange for the operating fees paid by the PROJECT COMPANY from the project's revenues.

2. The OPERATOR may also be an equity participant in the PROJECT COMPANY.

H. DEVELOPER.

1. The DEVELOPER will assist the PROJECT COMPANY in the development of the project in exchange for development fees.

2. The DEVELOPER may also be an equity participant in the PROJECT COMPANY.

III. GOVERNMENT--A CLOSER LOOK. Because the GOVERNMENT is turning over to the private sector an activity it would otherwise engage in itself, the GOVERNMENT plays a very large role in the "BOT" transaction.

A. Advantages of the "BOT" Deal for the Government.

1. Off-Balance Sheet Financing. The principal advantage of the BOT transaction from the GOVERNMENT's perspective is that the GOVERNMENT is able to get a necessary project implemented without borrowing or guaranteeing the debt or taxing the public to raise revenues.

2. Upside potential. In those transactions where the GOVERNMENT becomes an equity participant in the PROJECT COMPANY or negotiates some other revenue sharing arrangement, the GOVERNMENT is also able to participate in any upside from profits. For example, when Turkey's state run telecommunications network offered a $100m mobile phone project to build the switchboards

and networks under a BOT scheme, the state originally asked for a $500m license fee and then accepted a bid offering a revenue share of 52% with a 1% annual increase for eight years.

3. <u>Foreign investment.</u> The GOVERNMENT is able to attract foreign investment that it would not otherwise attract in a typical "turnkey" construction project.

B. <u>"Cost" to the GOVERNMENT</u>

1. <u>Concession</u>. The GOVERNMENT grants the PROJECT COMPANY a CONCESSION pursuant to a CONCESSION AGREEMENT.

   a. In so doing, the GOVERNMENT cedes control for the duration of the CONCESSION over an important aspect of the national economy--its infrastructure--to persons who may not have the greater interests of the nation as a top priority.

   b. As discussed more fully below, the CONCESSION AGREEMENT will have a significant bearing on the controls the GOVERNMENT may exert on the PROJECT COMPANY and on the eventual structure of the financing including the security arrangements.

   c. Initially, the PROJECT COMPANY may sign an implementation agreement which gives it the license to act with respect to an activity that would otherwise be a state monopoly.

   d. This will need coordination with the particular agency traditionally in charge of the activity.

2. <u>Approvals, etc.</u> The GOVERNMENT also grants the necessary approvals, authorizations and consents for the construction and operation of the project.

C. <u>Concession Agreement</u>: In the CONCESSION, the GOVERNMENT grants the franchise subject to a series of conditions. These conditions are spelled out in the principal document to be negotiated between the GOVERNMENT and the PROJECT COMPANY -- the CONCESSION AGREEMENT. The CONCESSION AGREEMENT should set forth the rights and obligations of the PROJECT COMPANY under the CONCESSION and describe all limitations and conditions of the CONCESSION. These rights, obligations, limitations and conditions frequently include the following:

1. <u>CONCESSION.</u> The agreement will describe the concession which is the franchise granted by the GOVERNMENT. It may also include other benefits such as a "no further tax" clause. See discussion at paragraph D, below.

2. <u>CONCESSION PERIOD.</u> The CONCESSION PERIOD is the period of time for which the CONCESSION has been granted to the PROJECT COMPANY. This may be limited to a stated number of years or other benchmark, such as repayment of the debt attributable to construction of the project.

   a. The CONCESSION PERIOD is generally sufficient for the PROJECT COMPANY to recoup its outlay with a sufficient rate of return to make the investment attractive to investors.

      (1) British Channel Tunnel - 50 years

      (2) Malaysia N/S Highway - 30 years

      (3) Power generating plants - 15-30 years

      (4) In lieu of years, the parties may choose other benchmarks, such as when debt financing is repaid. For example, the CONCESSION PERIOD with respect to the Dartford River Crossing (the bridge and tunnel across the Thames River) is 20 years but the project is required to be transferred back to the UK Government four years earlier if the project performs as forecast or better.

   b. Some PROJECT COMPANIES take the position that the longer the term of the CONCESSION PERIOD, the lower the price overall.

3. <u>Performance Conditions</u>. If the PROJECT COMPANY fails to achieve certain benchmarks of completion or goals within a stated period it may forfeit the CONCESSION.

4. Extent of Monopoly. The CONCESSION AGREEMENT will also spell out the extent of the PROJECT COMPANY'S monopoly. There a number of conflicting needs to be balanced.

a. On the one hand, the PROJECT COMPANY may be unwilling to undertake a project, such as building a railroad line, if the government is then free to use the road bed (which is now graded) to build a competing line.

(1) In the English Channel deal the English and French GOVERNMENTS agreed not to facilitate a second link to be built by others to open before the end of year 2000. The GOVERNMENTS also agreed that during the CONCESSION PERIOD no link would be financed with public funds or through the use of any governmental guarantees.

(2) An example of what can happen when the monopoly issue is not addressed can be seen in Thailand. In 1988 a PROJECT COMPANY in Thailand received a CONCESSION to build a 20-mile expressway which included tax breaks and a 30 year operating concession. But in 1992 when the PROJECT COMPANY had completed over 12 miles of the roadway, it learned that a rival scheme was being proposed that threatened to compete with the roadway for toll revenues. The PROJECT COMPANY was considering a claim against the GOVERNMENT.

b. On the other hand, once a nongovernment entity is providing a product or service, it may seek to do so in a fashion that maximizes its return.

(1) For example, without any competition or control, the PROJECT COMPANY, realizing that it must eventually turn over the project to the GOVERNMENT any way, may seek to maximize its profits by driving up tolls.

(2) This may render the project unaffordable, and thus unusable by the local population; notwithstanding the

fact that the monopoly power originally belonged to the "people".

(3) Similarly, the PROJECT COMPANY may allow the project to fall into disrepair as the time comes for "turnover".

(4) Thus, it is often necessary to create a new regulatory scheme for the new private industry to assure some accountability for the general welfare.

c. Accordingly, pricing and maintenance must be controlled through the concession or regulation.

(1) To some extent the market should regulate the PROJECT COMPANY's "greed"; if users can't afford the tolls, the project will not generate the anticipated revenues and the project will be unable to pay off its debt.

(2) This market protection will be less effective, however, in those circumstances where the GOVERNMENT has guaranteed minimum patronage.

D. <u>Tax Incentives.</u> Many developing countries offer attractive tax incentives to foreign investors in the PROJECT COMPANY.

1. <u>Examples.</u> These often include tax incentives such as tax holidays, investment tax credits and reduced corporate tax rates.

2. <u>Benefits of tax incentives.</u> These benefits make the PROJECT COMPANY more profitable by reducing one major expense of the PROJECT COMPANY during the enterprise's initial period. Of course, these benefits need to be weighed against the reduction in tax revenues to the GOVERNMENT from the PROJECT COMPANY.

a. Vietnam, for example, recently extended tax breaks already given for joint ventures to wholly owned foreign investment projects in certain instances in key sectors.

b. Vietnam also exempts foreign joint ventures in priority sectors from paying a 15-25% profit tax for the first two years and makes them eligible for a 50% tax reduction for an additional two years.

3. Limits of tax incentives. Tax codes, however, may always be changed. If the tax law is reflected in the "law of the land", it is safe only until the next day that the legislature meets.

a. Foreign investors will want covenants in the deal documents themselves (such as in the CONCESSION AGREEMENT) contractually obligating the GOVERNMENT to its commitments on tax issues.

b. For example, in Alcoa Minerals of Jamaica, Inc. v Government of Jamaica the parties had entered into an agreement concluded in 1968 for a term of 25 years. Alcoa agreed with Jamaica that it would construct an aluminum refining plant in Jamaica. Jamaica agreed to grant Alcoa long term concessions for the mining of bauxite in Jamaica. The agreement contained a "no further tax" clause pursuant to which Jamaica was not to impose on Alcoa's mining and refining operations any taxes other than those expressly provided for in the agreement. The agreement also contained a dispute resolution clause providing that all disputes would be resolved by the International Centre for the Settlement of Disputes. ("ICSID"). In 1974, Jamaica announced that taxes on the mining of bauxite were to be increased and sought to withdraw its consent to dispute resolution by the ICSID. The arbitration tribunal held that the dispute was within its jurisdiction and that the Jamaican notification did not affect its agreement to arbitrate; effectively, the "no further tax" clause contained in the agreement was enforceable notwithstanding the change in the law with regard to arbitrable disputes.

c. Moreover, tax incentives are attractive to an investor only if the PROJECT COMPANY is profitable, the investor can get a reasonable return on its investment, and can remit its profits to its own country. Benefits from the PROJECT COMPANY will be of little use to a foreign investor if they are trapped in the host country. (See, discussion below.)

E. Other Significant Issues. There are several other significant issues that the GOVERNMENT must confront in its efforts to create a hospitable environment for foreign investors. These include:

1. Sovereign Guarantees Against Political Risks. One obstacle to satisfactory conclusion of several BOT deals has been the requirement by BANKS and equity participants for sovereign guarantees. A great deal of effort is being used to obtain these guarantees for investor comfort with regard to features such as investor protection, repatriation of profits across borders and foreign exchange.

a. Investor protection agreement.

(1) Investors will often look for a clear signal from the host country that there is a strong political will to open up the country to foreign investment and that such investments will be protected from nationalization.

(2) Foreign investors frequently want an agreement which will prevent the host country from nationalizing the investment or will look to see if there are laws obligating the host country to provide compensation if it nationalizes the investment. Such laws:

(a) recognize the sovereign's right to nationalize foreign property

(b) but place conditions on the proper exercise of that right, including that the exercise of the right:

i) must be for a public purpose;

ii) must be nondiscriminatory, not directed specifically against a foreign person; and

iii) must be accompanied by prompt, adequate and effective compensation.

b. Exchange Control. No investor wants to find that all of its profits in a flourishing business are locked in local currencies which cannot be remitted to its home country. Accordingly, exchange rates and repatriation issues will affect an investor's perception of an investment opportunity. Equity participants in the PROJECT COMPANY and the BANKS will want assurances that the PROJECT COMPANY will be able to exchange its local cash flow into other currency so as to be able to service its debts.

(1) For these reasons the Polish privatization law specifically allows income received by foreign parties to be transferred abroad. Chile, Ghana, Zaire, China, Argentina and Korea have also recently liberalized their rules on profit transfer.

(2) In fact, one Vietnam BOT deal was facilitated by use of a quota system for foreign companies enabling a repatriation of funds in hard currency. Unused quotas from some companies could be swapped with those of other companies enabling the PROJECT COMPANY to generate hard currencies.

(3) Of course, repatriation and exchange provisions of this sort must be crafted carefully so that they do not create a large continuing drain on the host country's foreign exchange reserves. Such a drain would increase as business increased; it would run counter to a common purpose of privatization, which is to make the local economy more productive and profitable.

c. Currency. The price and the currency in which the price is to be paid must be resolved to the satisfaction of the parties

(1) Apparently, one of the reasons the Ankara Metro BOT scheme in Turkey failed to attract bank support was the difficulty of matching the project's external debt servicing needs with the Turkish lira revenue flows from the Metro's tolls.

(2) In contrast, part of the electricity to be purchased from the Shajiao C 3 x 660mw power plant in the Guangdong province is to be paid for in foreign currency, including U.S. dollars. Performance of this foreign currency obligation is guaranteed by a major provincial level financial institution in Guangdong. This is a factor which makes this deal attractive to BANKS.

2. <u>Resource Risk.</u> The issue of resource risk is another matter of significant concern and arises in at least two ways. First is the issue of whether or not the project will generate sufficient revenues to allow the PROJECT COMPANY to repay the debt. This issue is often addressed in an offtake arrangement. Equally important, is the issue of whether the project will have access to adequate supplies of necessary resources, such as water for a hydroelectric project, to permit it to be viable. This issue is typically addressed through supply agreements.

a. <u>Offtake Arrangements.</u> In some, but not all, BOT transactions, the GOVERNMENT will enter into offtake agreements with the PROJECT COMPANY whereby it guarantees to "take or pay" for a specified quantity of product or in some instances minimum patronage by future customers.

(1) For example, in the Turkey Water Project, the governmental authority will undertake to buy a certain amount of water a year.

(a) The terms of the agreement require the purchaser to pay for the water whether or not he takes delivery.

(b) The PROJECT COMPANY also intends to secure an offtake agreement from the Istanbul water authority pursuant to which the municipal authority will sell water to its Istanbul counterpart.

(2) Similarly, in the Turkey hydro-electric project the financial advisers have required that the PROJECT COMPANY secure a sales agreement with the state owned power utility to buy the project's electricity.

b. <u>Supply Arrangements.</u> In some instances the parties will also want assurances that there will be adequate resources to operate a project.

(1) For example, in the Turkey hydro-electric project, an accord will be struck with the state hydraulics corporation to guarantee that the upstream dam discharges a certain volume of water to enable the project's turbines to operate.

(2) Similarly, the Shajiao C 3 x 660mw coal fired power station to be built in Guangdong province requires the substantial Chinese parties to both supply coal to the station and purchase at least 61% of the generated electricity.

3. <u>Other protection.</u> In Sri Lanka, for example, the GOVERNMENT is hoping that a 450m power station will be built on a BOT or BOO basis to sell electricity to the national grid. Recognizing that terrorists could attack the supply line which will feed electricity from the station into the national grid, the GOVERNMENT has expressed willingness to fund an insurance policy that would cover sabotage.

4. <u>Treatment of foreign capital compared with local capital.</u> Several countries have amended laws treating local capital more favorably than foreign capital.

5. Administrative process. It is helpful when the government bodies involved in applying for applications for foreign investment are coordinated. Egypt, for example, has instituted a "one stop" investment application center under the auspices of its Investment Authority which has eased the application path.

6. Restrictions with respect to foreign investments.

   a. In some countries certain business sectors are restricted to local participation; for example, defense related industries and the media. Other industries may not totally bar foreign participation but laws may require a minimum percentage of local participation. In such instances, issues of control may arise.

   b. One innovative way of dealing with this problem is found in the Philippines. Under the 1992 Investment Priorities Plan projects which are granted so-called "pioneer" status allow foreigners to own a majority stake; those registered as non-pioneer projects limit foreign ownership to 40%. A power project will be granted "pioneer" status if, for example, it uses or converts to coal status.

7. Labor laws and conditions. Investors will often consider the legal framework relating to labor and industrial conditions.

   a. In Egypt, for example, the labor law makes dismissal of an employee after one year of service dependent on a tribunal hearing.

   b. In some cases--such as Conrail in the United states--the GOVERNMENT will give the PROJECT COMPANY a holiday from certain labor laws.

   c. The benefits of such laws need to be weighed against the costs.

8. Environmental laws. A potential investor will be interested in the status of the environmental laws in the host country, including:

a. the rules, if any, requiring spending on environmental protection which would increase the cost of investment;

b. the strength of environmental groups in the host country; for example, when an environmental group in the Philippines recently obtained an injunction against the construction of a $888m power plant, the Supreme Court reissued a 1991 presidential decree prohibiting lower courts from blocking valuable infrastructure projects;

c. the penalties for infringement of environmental laws; and

d. the adequacy of the host country's facilities to deal with an emergency arising from the hazardous materials.

9. Intellectual property rights. If the investor or PROJECT COMPANY has valuable intellectual property rights, the PROJECT COMPANY will want legal protection for such rights. The investor will also want to become familiar with the

a. costs and processes for registering a patent, if any, and

b. whether the host country is a party to any international agreements protecting intellectual property rights.

10. Settlement of disputes. It is advisable for the parties to specify how disputes are to be settled; i.e. by negotiation, conciliation, arbitration, referee, litigation or a combination thereof, where the proceeding is to occur and the language or languages in which the proceeding is to be conducted. The parties should keep in mind that it is advisable, particularly during construction, for disputes to be settled speedily so as not to disrupt construction.

a. Negotiation. Negotiation is usually the most satisfactory way to settle disputes. However, where negotiations break down the parties may wish to attempt conciliation (such as through the UNCITRAL Conciliation Rules) before resorting to arbitral or judicial proceedings.

b. International arbitration. Because of the perceived "unfairness" of having disputes settled in either the host country or the investor's country, parties often opt for international arbitration.

(1) The investor will want to know that the government official agreeing to the arbitration clause has the power to do so. For example, in some countries national legislation or the national constitution supersedes contractual provisions under which an arbitrator would pass judgment on the exercise of sovereign state powers or would affect public institutions.

(2) The investor will also want to know what if any special procedural requirements are imposed by national law. It is common for example, to require a document, the compromiso, signed by the parties to the arbitration clause, which submits the specific dispute to arbitration. The theory behind this is that the parties will begin to come together in the process of framing the dispute for submission to arbitration. However, a party can use this process for delay.

(3) The investor will want to know to what, if any, conventions the host country is a signatory.

c. Litigation. If the parties wish to settle disputes in judicial proceedings, the parties may choose to include an exclusive jurisdiction clause and designate the choice of law.

11. Duties. Because the PROJECT COMPANY is likely to be importing equipment and supplies into the host country, the extent of duties imposed by the host country on such imports will be an important consideration to the PROJECT COMPANY. The Indonesian government, for example, recently cut duties on the importation of power plant and transmission equipment.

12. Force majeure. One problem faced by the parties to the BOT deal is a formula in the case force majeure interrupts the revenue flow and in turn, the ability of the PROJECT COMPANY to repay the debt.

a. Force Majeure refers to events which may occur and impede the performance of a party of his contractual obligation.

(1) Force Majeure clauses often exempt a party from the legal consequences of its failure where such failure to perform was an event beyond that party's control.

(2) For example, while the PROJECT COMPANY accepts the risk the project will not generate sufficient revenues to repay the debt, the PROJECT COMPANY may be unwilling to take the risk that the project will fail to provide sufficient revenues because it has been nationalized.

(3) To a large extent this concern will be addressed in the CREDIT AGREEMENT between the BANKS and the PROJECT COMPANY. It will also be addressed in the CONSTRUCTION CONTRACT between the PROJECT COMPANY and the CONTRACTOR. In both instances, however, the parties may look to the GOVERNMENT for guarantees or assurances.

b. In the Turkey Water Project, for example, a subordinated loan mechanism, in effect a standby facility which will repay the BANKS in event of force majeure, is envisaged, although it is unclear who the subordinated lender would be. The level of the loan would decrease during the "less risky" operational period.

7. PROJECT COMPANY--A CLOSER LOOK

A. Ownership of the PROJECT COMPANY. One of the most difficult tasks in the "BOT" transaction is for the CONTRACTOR and/or the GOVERNMENT to find credible equity partners with sufficient strength to carry out the tasks necessary to complete the project.

1. CONTRACTOR. Typically the CONTRACTOR is a significant equity participant in the PROJECT COMPANY.

2. EQUIPMENT MANUFACTURER and SUPPLIER as potential allies. To the extent that equipment manufacturers and suppliers are involved in the PROJECT COMPANY as equity participants, rather than strictly as suppliers under contractual arrangements, the risk is spread and the focus of these members of the team is sharpened because they now have an equity investment to protect.

3. Equity Markets. Where substantial equity is required the parties may need to look at the equity market. However, in view of long lead times associated with infrastructure projects it is often difficult to get support from institutional shareholders.

4. Banks. In some instances--such as Orlyval which is the light rail link between Central Paris and Orly airport in France and the English Channel Tunnel--the BANKS have opted to be equity participants as well as lenders.

5. Example. The $700m Turkish Water Project (involving the completion of the Yuvacik dam (work was suspended 5 years ago because of cash shortages), involving construction of a major water treatment plant with two major pumping stations together with over 100km of trunk mains to Istanbul) will be financed by 15% equity and 85% debt. The foreign CONTRACTOR will invest 25% of the equity, two Turkish contractors will invest a similar amount of equity, the Turkish municipality will invest 30% of the equity and a joint venture of the steel pipe suppliers will also contribute equity.

B. Form of PROJECT COMPANY. The corporate structure of the PROJECT COMPANY must be resolved.

1. Foreign participation. At the outset the GOVERNMENT should clarify its policy on foreign equity restrictions. See discussion at paragraph III.E.6., above.

2. Corporate structure. A number of issues need to be considered in forming the corporate structure. These include:

   a. In some countries, such as Taiwan, the law requires that a special purpose company be formed for certain projects. The investors are then required to establish the new company with paid in capital without any assurance that the contract will ever be awarded.

   b. In the English Channel BOT transaction the corporate structure took the form of a joint venture between the French and English companies which had received the CONCESSIONS.

3. AGREEMENT AMONG PROJECT COMPANY PARTICIPANTS. Regardless of the structure, the equity participants need a comprehensive partnership, joint venture, shareholder or other similar agreement reflecting their rights and obligations to the PROJECT COMPANY and to each other.

4. CONSTRUCTION CONTRACT. The PROJECT COMPANY will enter into the CONSTRUCTION CONTRACT with the CONTRACTOR. See discussion at paragraph V.C., below.

CONTRACTOR--A CLOSER LOOK

A. Advantage for the CONTRACTOR. The CONTRACTOR is able to secure the order or contracting services for the project from which its profits derives. Also, the CONTRACTOR has the potential upside return from its equity investment in the PROJECT COMPANY.

B. "Cost" To the CONTRACTOR.

   1. Capital Contribution. The CONTRACTOR is expected to contribute the initial equity or seed capital of PROJECT COMPANY.

   2. Construction Risks. The CONTRACTOR will take the risk of constructing the project on line at a stated cost:

C. <u>Construction Contract.</u> The principal agreement negotiated between the PROJECT COMPANY and the CONTRACTOR is the Construction Agreement. The significant construction issues include:

1. <u>Cost overruns</u>. A common problem in construction scenarios is that of cost overruns; in projects such as these the controversy is not unusual, it is just bigger.

   a. For example, in the English Channel deal there have been several rows over the cost estimates which increased over 50%, who is to blame and who is to pay. The CONTRACTOR takes the position that it has a contract to design and build a system to meet certain requirements. The PROJECT COMPANY takes the position that as the owner and future operator, it has a duty to protect its shareholders and wants the best possible system.

   b. A well drafted CONSTRUCTION CONTRACT should anticipate this controversy and address who will pay for increased costs arising from events such as changed orders, force majeure, and delays caused by disputes over the construction contract.

2. <u>Intellectual Property.</u> The PROJECT COMPANY will want to insure in the CONSTRUCTION CONTRACT that it receives the necessary technology transfers in respect of technical documentation, spare parts, maintenance and repairs of the project. The GOVERNMENT will want to insure that at the end of the CONCESSION PERIOD the technology is transferable to it, along with the project. Additionally, the GOVERNMENT may want to require the CONTRACTOR or PROJECT COMPANY, prior to the expiration of the CONCESSION PERIOD, to train local personnel to operate and maintain the project after the CONCESSION PERIOD.

3. <u>Warranty</u>. The CONSTRUCTION CONTRACT should contain a quality guarantee.

4. <u>Liquidated Damages, Milestones and Penalty Clauses.</u> These provisions are a means of placing some of the construction risk on the CONTRACTOR.

D. Operating Contract. A second contract to be negotiated with the CONTRACTOR is the Operating Contract. The project may be operated by the Contractor under an operating contract or by an operator where management and operation of the project lies elsewhere

VI. COMMERCIAL BANKS--A CLOSER LOOK. The COMMERCIAL BANKS generally act as lenders in the BOT transaction; although there are some instances where the BANKS are equity participants. In the English Channel deal there was a 20/80% equity debt split, which was based on the underwriting bank's view at the time of the level of debt the revenues would support and its perception of the equity market.

A. Advantages to the BANK.

1. The BANK earns interest on its loan and expects more favorable rates in exchange for taking the market risks of a limited recourse loan.

2. In those instances where the BANK is also an equity participant in the PROJECT COMPANY, the BANK has the upside potential of profits.

3. The BANKS are able to be involved in financings which were previously financed by the public sector.

B. "Costs" to the BANK. The BANK assumes some of the market risk since the debt is limited recourse debt -- that is, repayment of the debt will emanate solely from the revenues generated from the project.

C. Credit Agreement. The principal agreement to be negotiated between the BANK and the PROJECT COMPANY is the CREDIT AGREEMENT.

D. Guarantee. BANKS often wish to see a sovereign guarantee, that is a guarantee from the GOVERNMENT eliminating certain of the risks that would otherwise fall on the BANK as a result of the limited recourse nature of the BOT transaction. See discussion of sovereign guarantees at paragraph III.E.1, above.

E. Risks. In evaluating the credit risk of the project (and in making its lending decision) BANKS tend to consider the following levels of risk:

1. Technical. Can the project be built in time, to specifications and within budget?

2. Managerial. Is management adequate and experienced?

3. Economics.

   a. Is there a market demand such as to give confidence in future revenue expectation?

   b. Is revenue stream such as to enable full repayment of debt to be achieved within the CONCESSION PERIOD?

4. Political.

   a. Is there sufficient political will to help the project succeed?

   b. Is the residual political risk acceptable?

VII. PRIVATE USERS/CONTRACTUAL OFFTAKERS.

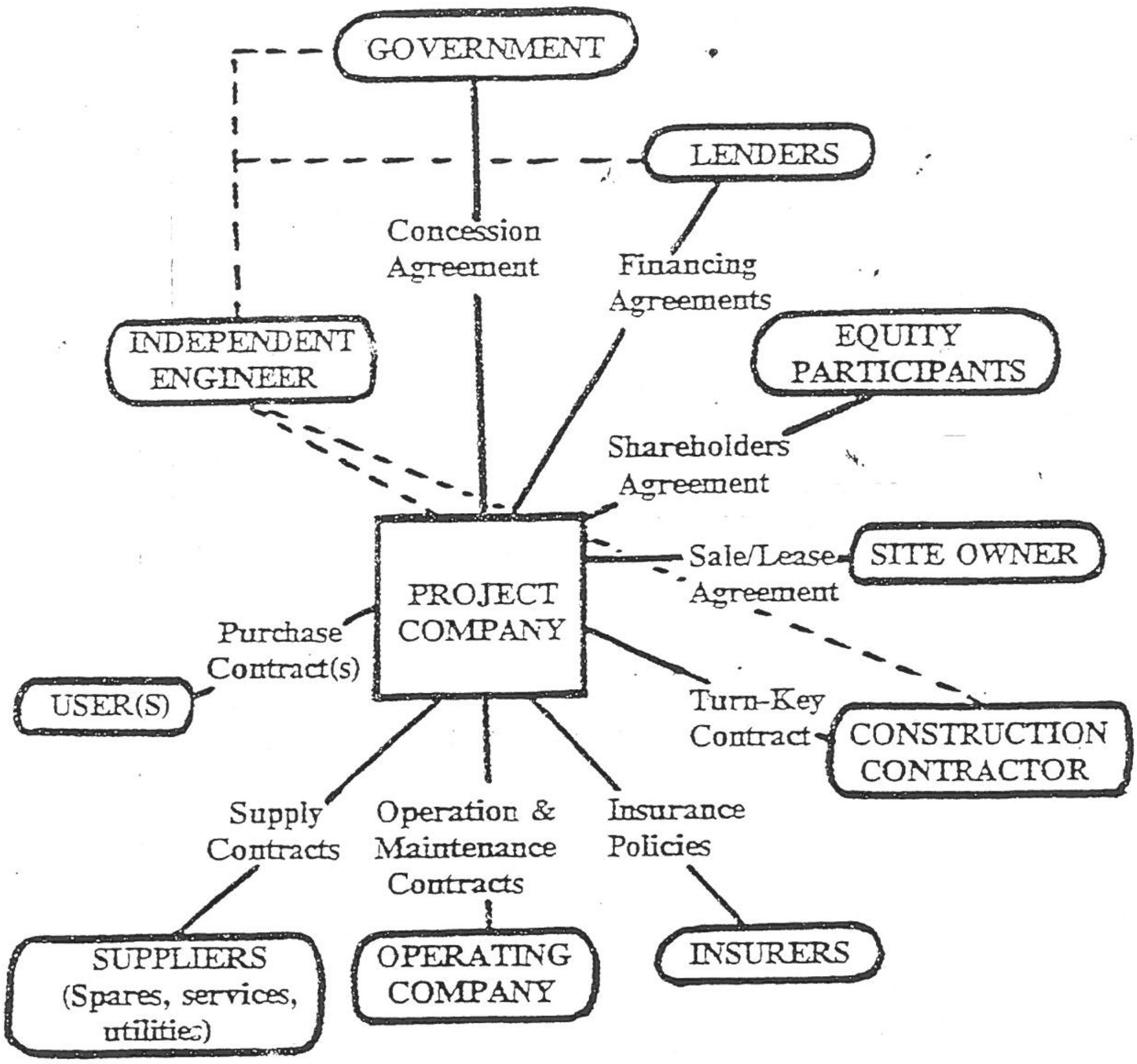
A. The PRIVATE USERS and CONTRACTUAL OFFTAKERS are those who will ultimately make use of the project and pay the revenues. The PRIVATE USERS will either receive the service directly from the PROJECT COMPANY or indirectly through the GOVERNMENT or other CONTRACTUAL OFFTAKER, depending on whether the PROJECT COMPANY is permitted to sell directly to PRIVATE USERS or whether the PROJECT COMPANY must sell all of its product to the GOVERNMENT or CONTRACTUAL OFFTAKER which will then sell to PRIVATE USERS.

B. PRIVATE USERS will want to know that the PROJECT COMPANY will not be able to set prices at a rate which will make the project unusable by the PRIVATE USERS.

VIII. OPERATOR. The project will typically be operated by the CONTRACTOR under an OPERATING AGREEMENT. Where, however, the CONTRACTOR does not have the necessary expertise, the project will be operated by an OPERATOR.

IX. DEVELOPER. The DEVELOPER will assist the PROJECT COMPANY in the development of the project in exchange for development fees. The DEVELOPER may also be an equity participant in the PROJECT COMPANY.

PARTIES TO TYPICAL BOT TRANSACTION



TIMELINE FOR PORT BOT PROJECT

1. GOVERNMENT DECISION TO SEEK PRIVATE PARTICIPATION
2. PREPARATION OF TENDER DOCUMENTATION AND PREQUALIFICATION OF POTENTIAL TENDERERS
3. SUBMISSION OF TENDERS
4. SELECTION OF WINNING TENDER AND AWARD
5. NEGOTIATION OF CONCESSION AGREEMENT
6. PROJECT DEVELOPMENT
7. NEGOTIATION OF MAJOR PROJECT AGREEMENTS
8. NEGOTIATION OF FINANCING AGREEMENTS
9. FINANCIAL CLOSE
10. CONSTRUCTION PHASE
11. ACCEPTANCE AND COMMENCEMENT OF COMMERCIAL OPERATION
12. OPERATION
13. RENEWAL OR TRANSFER AT EXPIRY OF TERM

PROJECT RISK ANALYSIS

CONSTRUCTION PHASE

Delay Risk
Completion Risk
Performance Risk
Cost Overrun Risk
Contractor Risk
Permit Risk
Environmental Risk

OPERATION PHASE

Market Risk
Regulatory and Tariff Risk
Product Supply Risk
Contractor Risk
Inflation Risk
Foreign Exchange Risk
Interest Rate Risk

ALL PHASES

Country Risk
Political Risk
Natural Force Majeure Risk

TRANSFER

RISK ANALYSIS DECISION TREE

DEFINITION

POSSIBLE GAIN — yes → COST/BENEFIT ANALYSIS

no ↓

AVOIDABLE —— yes → PROVISION

no ↓

CONTROLLABLE — yes → INCIDENTAL ABSORPTION

no ↓

INSURABLE —— yes → COST/BENEFIT ANALYSIS

no ↓

ALLOCATION

but:

RESIDUAL RISK

TERM SHEET ITEMS

1. PARTIES; ESTABLISHMENT OF PROJECT COMPANY

2. PROJECT SCOPE AND DESCRIPTION

3. MILESTONES FOR PROJECT IMPLEMENTATION

4. RESPONSIBILITIES OF PARTIES

   A. DURING DEVELOPMENT PHASE

   B. DURING CONSTRUCTION PHASE

   C. DURING OPERATION PHASE

5. FINANCING AND SECURITY PACKAGE

6. INSURANCE

7. FRANCHISE FEE, LEASE RENTAL AND OTHER PAYMENTS BY PROJECT COMPANY

8. DEFAULT AND LIQUIDATED DAMAGES

9. FORCE MAJEURE

10. EARLY TERMINATION AND PAYMENTS

    A. DURING DEVELOPMENT PHASE

    B. DURING CONSTRUCTION PHASE

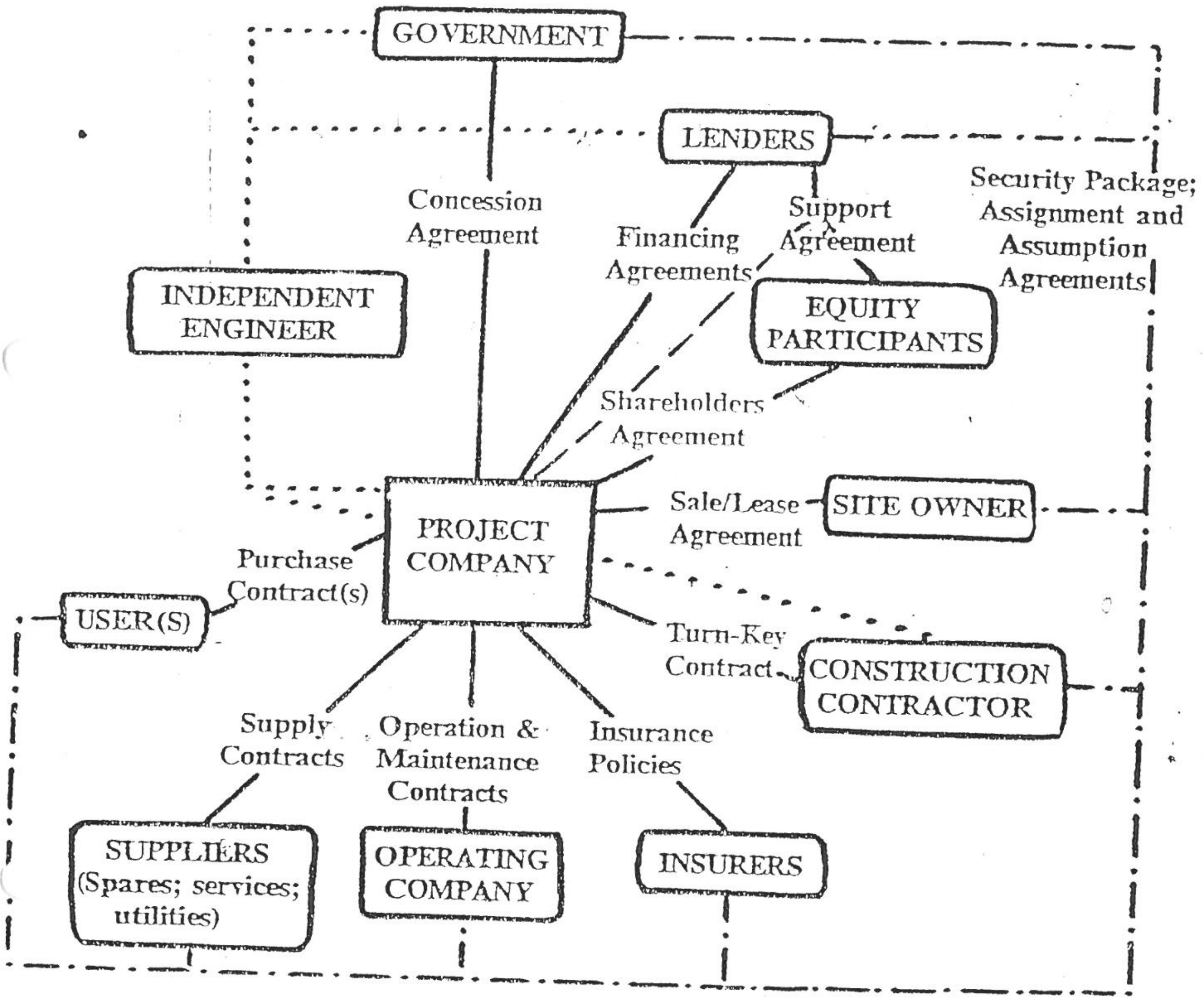
    C. DURING OPERATION PHASE

11. BUYOUT BY AUTHORITY; EMERGENCY POWERS

12. TRANSFER

13. DISPUTE RESOLUTION, GOVERNING LAW

PARTIES TO TYPICAL BOT TRANSACTION



COMPENSATION DUE FROM AUTHORITY UPON EARLY TERMINATION

I. BEFORE COMMERCIAL OPERATION

TERMINATION EVENT	COMPLETED WORKS	MOBILIZATION/ DEMOBILIZATION COSTS	LOAN	RETURN ON EQUITY
Termination for Convenience				
Authority Event of Default				
Political Force Majeure				
Natural Force Majeure				
Project Company Event of Default				

II. AFTER COMMERCIAL OPERATION

TERMINATION EVENT	CIVIL WORKS	MOVABLE ASSETS	LOAN	RETURN ON EQUITY
Termination for Convenience				
Authority Event of Default				
Political Force Majeure				
Natural Force Majeure				
Project Company Event of Default				

TRANSFER TERMS

AUTHORITY POSITION

1. The Terminal is to be transferred to the Authority fifteen (15) years after the execution of the Concession Agreement.

2. Prior to the expiry of the term of the Concession Agreement, the Authority may invite competitive bids from private sector operators.

SPONSORS POSITION

1. The Terminal is to be transferred to the Authority twenty-five (25) years after the commencement of commercial operation of the Terminal.

2. Not later than eighteen (18) months prior to the expiry of the term of the Concession Agreement, at the request of either party, the Authority and the Project Company shall commence negotiations with a view toward extending the Concession Agreement.

   If no agreement on an extension is reached not later than twelve months prior to the expiry of the term of the Concession Agreement, the Authority shall invite competitive bids from private sector operators.

   The Project Company has the right to participate in the bidding and has the right to match the best offer received by the Authority.

AUTHORITY POSITION

3. Upon expiry of the term of the Concession Agreement, the Project Company shall transfer clean and unencumbered title to all movable and immovable assets comprising the Terminal to the Authority for a nominal consideration of one United States Dollar (US$1).

SPONSORS POSITION

3. Upon expiry of the term of the Concession Agreement, the Project Company shall transfer | title to all movable and immovable assets comprising the Terminal to the Authority <u>as follows:</u>

    <u>a.</u> <u>Civil works</u> for a nominal consideration of one United States Dollar (US$1);

    <u>b.</u> <u>Other assets at fair market value;</u>

    <u>c.</u> <u>Goodwill.</u>

    <u>The Authority shall assume all liabilities (other than those incurred in connection with the initial financing of the Terminal) of the Project Company with respect to the Terminal that will become due and payable after the expiry of the term of the Concession Agreement.</u>

    <u>The Terminal and all assets shall be transferred "AS IS" without any warranties which would otherwise be implied by statute or otherwise.</u>

TRANSFER TERMS
(continued)

AUTHORITY POSITION	SPONSORS POSITION
4. Not later than six months prior to the expiry of the term of the Concession Agreement, the Project Company shall deliver: a. a complete list of all movable and immovable assets comprising the Terminal; b. a certificate certifying that the Terminal is in good repair and operating order, regular wear and tear excepted; and c. a timetable and procedures for the orderly handing over of the Terminal.	4. [Agreed.]
During the six month's period prior to the expiry of the term of the Concession Agreement, the Project Company shall associate nominees of the Authority in key management positions to ensure smooth handing over and transfer of the Terminal on the expiry date.	During the six month's period prior to the expiry of the term of the Concession Agreement, the Project Company shall <u>provide training for up to ten (10)</u> nominees of the Authority | to ensure smooth handing over and transfer of the Terminal on the expiry date.

TRANSFER TERMS
(continued)

AUTHORITY POSITION

5. All costs and expenses in connection with the transfer shall be borne by the Project Company.

SPONSORS POSITION

5. All costs and expenses in connection with the transfer (including the salaries and other benefits for nominees of the Authority to be trained by the Project Company) shall be borne by the Authority.