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Tanjung Jati - to B or not to B

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When the 1,320MW Tanjung Jati B expansion project in Indonesia reached financial close on 25 December 2008, it brought to an end an exceptionally complex two-year financing process. **Chaminda Jayanetti** looks at the latest episode of a deal that goes back to the earliest days of Indonesia's IPP scheme and forced developers, bankers and lawyers to truly go the extra mile to get the deal away.

History

Tanjung Jati B was one of the first projects to be conceived under Indonesia's embryonic IPP programme in the early 1990s. TJB was originally developed by Hopewell, a subsidiary of Consolidated Electrical Power Asia (CEPA), which was developing IPPs across Asia at the time.

However, amid the corruption-strewn rule of then-dictator Suharto, 20 per cent of the project equity went to PT Impa Energy - owned by one of Suharto's children - in order to get it through the door.

Sumitomo was EPC contractor on the 2 x 660MW project - located on Java - and provided US$400 million in supplier loans to fill a gap in financing. The expectation was that this would be retired with financing from alternative sources, but the entire project ran into trouble when the Far East economic crisis struck in 1997, with the plant half-built.

The Far East crisis was not the only obstacle to bring down the project. The plant had agreed to sell power at a relatively high US$0.0645/kWh to state utility PLN, a price that aroused suspicion of corruption. The World Bank was among many critics of the commercial arrangements.

Having invested so much money into TJB, Sumitomo was keen to keep the project alive. It spent a number of years considering different options to restructure the project. The agreement it ultimately reached was a build lease transfer (BLT) arrangement with PLN.

Under the 20-year BLT, Sumitomo bought out CEPA and PT Impa Energy and sponsored the project via its SPV, Central Java Power (CJP). CJP leased the power plant to PLN, which operated it. As a result, CJP's revenue came not from direct offtake revenue, but from PLN's lease payments.

The lease payments were based on a formula that took into account many of the same variables as a PPA - construction costs, debt interest - but not operating costs, as these were borne by PLN itself.

The original TJB deal reached financial close in 2003 with financing from JBIC and political risk insurance from NEXI, with the following commercial banks coming in on the deal:

- Bank of Tokyo-Mitsubishi
- BNP Paribas
- Shinsei Bank

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- SMBC
- Sumitomo Trust & Banking

The project came online in 2006.

Expansion

With Indonesia in desperate need of power, Sumitomo decided to launch a 1,320MW expansion to TJB. The new units would be called 3 & 4, on top of the original units 1 & 2, and would also operate under a 20-year BLT with PLN.

Sumitomo could have simply refinanced the old debt to cover capex for the new plant, as is standard for expansion projects. However, Sumitomo wanted JBIC financing for the expansion, and JBIC does not lend to refinancings, ruling out this avenue.

The BLT structure raised an issue that would lead to significant complications - the BLT license. The obvious way forward would be to create a new SPV for the expanded facility, thus separating the new project risks from the already-operating plant. However, a new SPV would require Sumitomo to apply for a new BLT license, which could have taken too long to secure.

Meanwhile CJP - as the SPV for units 1 & 2 - already held a BLT license. As a result, Sumitomo judged it would be more efficient just to use CJP's existing license and develop the new units under the same SPV as the old ones - essentially, using CJP as the vehicle for two separate project financings.

However, this strategy raised as many questions as it answered. The key challenge was to essentially fit two separate project finance transactions under the roof of one legal entity. Creating a subsidiary for 3 & 4 was not an option as CJP owned the land. The financing of 3 & 4 would not add new debt to 1 & 2, so the lenders to the original project financing would remain.

Therefore, with the two project financings operating under a single SPV, what would happen if the old plant ran into difficulty while the new plant was working fine? What if the new plant hit heavy construction overruns? With a single SPV covering both projects, the lenders to one project would in theory be able to seize the other project as collateral, regardless of how that other project was performing - or what the other project's lenders might feel.

Solution

Solving this issue was no easy process - financing TJB 3 & 4 took two years to complete. The final agreement effectively created two separate companies as the single legal entity of CJP.

The two companies were not subsidiaries - i.e. they were not separate legal entities - but the documentation was worded to give effect to the two project financings as separate companies. While there was only one legal entity, PLN and the lenders would treat the two projects as being different companies, with separate assets, operations, accounts, cash flows etc.

A key challenge in the financing process was cross-collateralisation - where the lenders to one project seize the assets to both projects as security. TJB 3 & 4 would not fly if the lenders on one project could seize the assets of both plants if their own plant got in trouble. Both lender groups would have to limit their ability under the intercreditor agreement to pursue the borrower where their project was in default but the other was not.

Persuading the original lenders to give up some of their rights was not easy. JBIC's involvement in both transactions gave comfort that the two deals would be treated even-handedly in terms of creditors' rights - a crucial element in getting TJB 3 & 4 through.

Distinguishing the assets of one project from the other was also a difficult exercise. There was a natural separation between the two plants' respective physical assets, but the most valuable security is the shares in the project company. But there is no way to separate shares relating to one plant from shares relating to the other.

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Ultimately, the best accommodation was to allow cross-collateralisation between the projects -- but with significant caveats, time suspensions and limitations in place before these rights of cross-collateralisation can be put into effect.

For example, should one of the projects default, Sumitomo has the right as sponsor to buy out the other project in order to stop in going under, protecting it while the creditors on the project in default seize that plant's assets.

The terms governing when creditors to a defaulting project can seize the assets of the healthy plant are elaborate, but essentially depend on what caused the default. If the default arises from a political risk issue, it would be dealt with according to the terms of the political risk insurance.

When CJP causes the default, the intercreditor agreement kicks in. In the event that construction delays to 3 & 4 trigger a financial default in 1 & 2, the lenders to the old plant are unlikely to want to take over the new project as they would take on the construction risk. But if CJP causes default during operation, there should be fewer obstacles to cross-collateralisation.

Essentially, when a default in one project would trigger a default in the other, and, if this happens, the lenders on one project could get hold of the collateral in the other - shares, cash flow, turbines etc - some assets can be seized and some cannot, depending on the cause of the default.

Financing

The total project cost is ¥200 billion (US$2.2bn), with an 80:20 debt-equity ratio:

- equity - ¥40bn (US$440m)
- debt - ¥160bn (US$1.75bn)

JBIC is providing 60 per cent of the debt - ¥96 billion (US$1bn) - as a direct loan, with the remaining ¥64 billion financed by commercial banks covered by JBIC four-point cover - essentially an extended political risk guarantee also covering PLN's payment obligations.

The tenor on the debt is 16 years door-to-door, including four years' construction - effectively 12 years post-construction, the same tenor as on the original financing in 2003. The lease lasts 20 years - also the same as for TJB 1 & 2.

The covered debt is provided by three banks, which equally underwrote the debt:

- Bank of Tokyo-Mitsubishi
- BNP Paribas
- SMBC

The covered debt was syndicated pre-financial close, with sell-down taking place on the same day as financial close so that no actual underwrite took place. The participant banks were not given MLA status:

- Calyon
- Mizuho
- Shinking Central Bank
- Sumitomo Trust & Banking

In addition to the senior debt, the project also includes a ¥25 billion (US$275m) subordinate loan to fund the sponsor's equity. This subdebt is guaranteed by Coastal Java Power, with a backstop to Sumitomo to enhance its credit.

The subdebt also has a 16-year door-to-door tenor, and is provided on a take-and-hold basis by the following banks, none of which took MLA status:

- Bank of Tokyo-Mitsubishi
- BNP Paribas

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- Shinsei Bank
- SMBC
- Sumitomo Trust & Banking

Of the ¥25 billion subdebt, only ¥20 billion (US$220m) was considered part of the ¥40 billion equity financing so as to maintain the 80:20 debt-equity ratio.

Pricing on the senior and subdebt was at a flat rate. Commercial bank debt was benchmarked to Yen Libor, while the JBIC loan was at a fixed rate not tied to any benchmark.

Advisers on the deal were:

- financial adviser to sponsor - Bank of Tokyo-Mitsubishi
- international counsel to sponsor - Paul Weiss
- local counsel to sponsor - Makarim & Taira S
- English counsel to Sumitomo - Denton Wilde Sapte
- international counsel to lenders - Milbank
- local counsel to lenders - ABNR
- Japan counsel to lenders - Nagashima Ohno & Tsunematsu
- Singapore counsel to lenders - Wong Partnership
- auditor and tax counsel to lenders - PricewaterhouseCoopers

Umbrella note

TJB 3 & 4 is also the first project to be financed under the umbrella note signed by JBIC and Indonesia's ministry of finance (MoF) in 2006 to facilitate Indonesian power deals. The umbrella note does not give an explicit MoF guarantee of PLN's undertakings to IPPs, but says that the ministry will support PLN in its obligations.

JBIC considered this sufficient to commit four-point risk insurance to the TJB expansion. The umbrella note is underpinned with supporting legislation, and as JBIC felt that a full MoF guarantee was unachievable, it settled for the umbrella note.

Although the note is not a full guarantee, there is nevertheless a strong political incentive for the Indonesian government to ensure PLN meets its obligations as JBIC is one of the country's biggest donors, and is likely to be crucial in financing the rapid expansion in total power capacity that Indonesia desperately requires.

Conclusion

To reach financial close on such a unique and complex transaction as Tanjung Jati B would have been a significant feat at the best of times - to do so in the midst of the credit crunch, even more so. The project reflects the continued health of the Japanese banking sector, the effectiveness of Indonesia's umbrella note - and the fact that when a country's lights are about to go out through lack of power, necessity truly is the mother of invention.

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