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Asia Infrastructure Group newsletter Edition 4 (December 2011)
Welcome and introduction

We work in interesting times, don't we? Could anyone have predicted just six months ago that by December 2011 we in Asia would find ourselves in a market such as the one we currently face? Comparatively, the Asia market remains reasonably buoyant when looking at the economic troubles in the US and in Europe. But many, including the World Bank President Robert Zoellick at the recent Infrastructure Summit held in Singapore, however, are suggesting stormy weather lies ahead in Asia. Is that really apparent to those of us living in Asia? Why must it be inevitable? Economically, some are saying Asia has really come of age and is standing strong, almost unmoved by global concerns. But let us test that in the infrastructure context.

On the plus side, we have seen completion of the Muong Dong 2 IPP in Vietnam. Has this set the precedent for the next batch of IPPs in Vietnam through? We have also seen Nexi cover for the Hanoi – Hao Phong Expressway with on-lending via Vietnam Development Bank. Most notably in Indonesia, closure occurred on the US$3 billion Central Java Power Plant. In the words of Phil Collins, financial closure on this was almost "against all odds". But it is done. And there are many who feel rightly proud to have been involved. Can the momentum be kept up through on the proposed Bandar Lampung Water Project in Sumatra or on the various proposed Indonesian mini-hydros? What about renewables projects in Thailand? Could these be completed now under the recently appointed Yingluck Shinawatra government?

On the down side, lender liquidity troubles continue, the impact of Basel III is being watched and solid deal flow remains elusive. The main issue facing the infrastructure market in Asia, as ever, is the number of poorly prepared deals coming to market. This serves no good purpose and simply exacerbates the delays in recovery/origination of fundamentally sound transactions.

So where are we?

Well, it is pretty clear that opportunities exist in Mongolia, but not for the faint-hearted perhaps. Indonesia is enjoying some interesting power, water and transportation deals coming to, or already in, the market notwithstanding what one energy sector veteran has recently described as "the apparent disconnect between the government view and the views of equity or debt investors". On greenfield opportunities it seems Vietnam is slowly plugging away. Quite slowly in terms of progress with the latest IPP projects. But on the bright side, the government is embracing proper project development thanks to support from Asian Development Bank and even considering a concept of viability gap funding. Multilateral Investment Guarantee Agency ("**MIGA**") is back in Singapore and International Finance Corporation ("**IFC**") has established a presence there too. Not all bad news.

So a mixed bag really. And that is without really touching on India, China or the "Stans". Perhaps few will get the big year-end bonuses once given out in recent times. But as one senior project finance banker recently commented publicly at an industry gathering "having a job is a bonus right now!"

Interesting times indeed…

James Harris
Head, Asia Infrastructure Group

November 2011

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Dealing with the unknown unknowns

By Timothy Hill (Partner, Hong Kong) and Rachael Guan (Senior Associate, Hong Kong)

The financial success of an infrastructure project often depends upon delivery on time within budget. However, as Donald Rumsfeld famously said "*there are unknown unknowns – the ones we don't know we don't know*" which inevitably generate risk to programme and cost. A well-drafted contract will not only seek to deal with the known unknowns but also seek to manage and allocate the risk of the unknown unknowns! One of the devices deployed is the provision of an effective mechanism to avoid and resolve the dispute.

We are increasingly asked to assist clients in developing or operating multi-dispute mechanisms, of which the FIDIC forms of contract provides a model. At the heart of the FIDIC model is the Dispute Adjudication Board ("**DAB**"). The role of the DAB is to make a prompt determination of the dispute, which under the Red Book parties are to promptly give effect unless and until it is revised in an amicable settlement or by an arbitral award. In *CRW Joint Operation v PT Perusahaan Gas Negara (Persero) TBK*, the Singapore Court of Appeal was obliged to consider the effect of a determination by a DAB under the 1999 edition of the Red Book.

In essence, a contractor had obtained a decision from the DAB requiring an employer to pay US$7 million. The employer gave a notice of dissatisfaction in accordance with the DAB procedure. The effect of the notice of dissatisfaction was to prevent the decision from becoming "final and binding". In accordance with the contract procedure, the contractor commenced an International Chamber of Commerce ("**ICC**") arbitration. The issue which was referred to arbitration was whether the employer was bound to give immediate effect to the DAB's decision. The arbitral tribunal considered the issue and gave a final award enforcing the DAB decision. In arriving at this determination the tribunal declined the employer's request to review the underlying merits of the dispute referred to the DAB. The tribunal considered that the employer could seek to address the underlying merits through a separate arbitration. The employer applied to set aside the arbitration award. The Court of Appeal considered that where a notice of dissatisfaction had been served in relation to a DAB decision, the arbitral tribunal must consider the underlying dispute. This decision significantly undermines the "pay now argue later" principle that many of the contracting community considered was intended to apply to DAB decisions, consistent with the trend of statutory adjudication which is becoming increasingly popular.

A further significant recent development is the publication in September of the ICC's new Rules of Conciliation and Arbitration. These are effective from 1 January 2012 and reflect a codification of best practice together with a number of innovations directed making the ICC process more attractive to international parties. Article 1(2) provides that only the ICC may administer arbitrations under the Rules. It is reported that a number of the leading international arbitral institutions have agreed to respect this provision and refrain from imitating the ICC procedure. The Rules also introduce the concept of an emergency arbitrator, drawing on the experience of the American Arbitration Association and the Stockholm Chamber of Commerce. This process is intended to permit emergency relief to be granted to a party to preserve the status quo pending determination of the dispute. Unfortunately, it is unlikely that this mechanism would assist the party holding a favourable determination of a DAB secure the relevant cash flow, because there is no mechanism for the emergency arbitrator or tribunal to make a temporarily binding determination. A further difficulty arises from the fact that the emergency arbitrator will make an "order", rather than award, giving rise to a question as to whether such determination would be recognised and enforced under the New York Convention. A further area of innovation within the Rules is an attempt to deal with the issues of consolidation and hearing together in respect of inter-related contracts. A full discussion of these issues is beyond the scope of this article, but readers should be aware that the mechanism deployed requires early decisions to be taken and therefore appropriate advice should be sought before commencing proceedings. In our opinion, whilst the Rules are helpful in this area there is no replacement for parties giving careful consideration to the issues of inter-relationship of contractual relationships at the time of entering into contractual arrangements.

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In summary, these developments serve to draw attention to the challenges of maintaining cash flow when the unknown unknowns are encountered. They serve to emphasize the need for consideration to be given to the structuring of project wide dispute resolution provisions, to ensure consistency in approach and timing. We have advised clients on a wide variety of dispute resolution mechanisms and the development of modelled dispute resolution processes suitable for a wide variety of infrastructure projects.

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China Development Bank: from China's policy bank to a world-class commercial bank?

By Jun Wei (Partner, Beijing) and Michael Zou (Senior Associate, Beijing)

The reform of China Development Bank ("**CDB**") in 2008 has transformed the once largest policy-oriented bank in China into a commercial bank. It has far-reaching effects on CDB's role to become the world's leading financier of cross-border infrastructure and energy projects. This article aims to explore the strategic role of CDB as of today and the opportunities ahead of its commercialization.

EARLY YEARS OF CDB

CDB was founded in 1994 as one of three policy-oriented banks in China, and was the only one given a ministry status which means that it reports directly to the State Council.

CDB's primary function was to implement the central government's macroeconomic policies and developmental plans through direct and indirect financing of key projects involving infrastructure and pillar industries in China.

However, since its establishment, CDB has faced a number of financial and systemic issues, including (a) low profitability; (b) a high non-performing asset ratio ("**NPA ratio**") (CDB's NPA ratio in 1997 was at a stunning 42%); and (c) severe corruption and public misfeasance of funds. These were mainly due to CDB's overriding policy to support state enterprises/industries/strategies, somewhat regardless of borrowers' credibility.

In these circumstances, the central government decided to implement a series of reform to improve CDB's efficiency and its capacity to cope with international challenges.

REFORM OF CDB

CDB's first reform was initiated in 1998 with the appointment of former Vice-Governor of the People's Bank of China ("**PBOC**") CHEN Yuan as its Governor. Chen brought about a number of substantive changes to CDB including (a) the engagement of PricewaterhouseCoopers to audit CDB in accordance with international accounting standards; (b) the implementation of Basel standards to CDB's practice; (c) the collaboration with the National Audit Office to combat public misfeasance of funds; and (d) the restructuring of CDB's portfolio to recover non-performing assets.

These changes were further reinforced by the long-waited commercialization of CDB in December 2008. The most-notable change from this is that CDB's credit scale becomes theoretically unlimited like other commercial banks, although there remains certain applicable policy limits. Moreover, CDB will continue to enjoy a zero-risk rating (as a sovereign financial institution) for RMB bonds it issues until the end of 2011. These have given CDB a competitive edge in funding its expanding operations. Indeed, in just two years after its commercialization, CDB has made a number of remarkable achievements including the following:

- financing over 80% of the central government's RMB4,000 billion investment plan since 2009;
- becoming the biggest international financier in China, with the percentage of loans it made to borrowers outside mainland China increasing significantly from below 1% in 2000 to 16.2% in 2010;
- closing numerous world-record deals, including (a) US$10 billion and RMB70 billion "Oil for Loan" financing with Venezuela in 2010 for various eligible infrastructure and other projects; (b) US$25 billion "Oil for Loan Agreement" with two Russian companies in 2009; and (c) the acquisition of a £1.5 billion major stake in Barclays in 2007;
- becoming the largest bond issuer in China (totalling RMB850 billion, including RMB5 billion issued in Hong Kong) after the Ministry of Finance and the PBOC; and
- successfully restructuring its asset portfolio whereby its NPA ratio dropped significantly from 42% in 1997 to 0.68% by the end of 2010.

The table below shows the key performance statistics of CDB in 2000, 2008 (prior to commercialization) and 2010, illustrating CDB's tremendous growth in recent years:

Key Performance Statistics	2010	2008	2000
Total assets (RMB/billion)	5,112	3,821	808
Loans outstanding, gross (RMB/billion)	4,509	2,899	672
Foreign currency loans outstanding (US$/billion)	141.3	97.9	4.4
Loans outside Mainland China as a % of total portfolio	16.2	4.65	<1
NPA ratio (%)	0.68	0.96	8.78

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CDB'S STRATEGIC ROLE AND OPPORTUNITIES AHEAD

Undoubtedly, CDB has evolved from a domestic bank to a leading international financier with a focus on project investment. In particular, CDB has a strategic role in carrying out China's various development plans:

- first, CDB is a convenient platform to channel funds for coping with the dire need for China's foreign currency reserve and for strategic enterprises to "go global". Indeed, CDB has already become the largest foreign investment bank in various countries, including Australia, Brazil and Venezuela. It also enjoys leverage from its leading role in the China-ASEAN Inter-bank Association for projects in "BRICS" jurisdictions;
- second, to fulfil China's "loan for resources" strategy, CDB finances the central government and other enterprises to acquire strategic resources, such as crude oil, coal, iron ores, power stations, etc. overseas. Specifically, 51% of the total outstanding loan balances of CDB in 2010 were applied to the coal, petrochemical, electric power and public infrastructure industries; and
- third, in a recent speech regarding the Euro crisis, Premier WEN Jiabao expressly stated that China will continue to lend a helping hand to Europe by making further investments. He further hinted that China prefers making substantive investments to simply acquiring treasury bonds. In this regard, the role of CDB as a project investment bank will become increasingly important for China's macro economy.

Accordingly, CDB, as the largest Chinese financier of medium to long-term projects, will continue to enjoy the opportunities and benefits from its strategic role for many years to come.

We frequently advise CDB, its branches or related parties, on international projects involving cross-border regulatory issues. Below are a number of deals on which we have recently acted/will act on:

EPC contract for 165MW Amalia Falls hydropower project in Guyana (~US$700 million)

This project comprises an Engineering, Procurement and Construction ("**EPC**") contract for the Amalia Falls hydropower project in Guyana, South America involving a 165 megawatts hydropower plant, 270km transmission lines and 2 new access roads (~85km long). The project will be carried out through a special purpose company – Amaila Falls Hydro, Inc. – formed solely for the purpose of developing, financing, constructing and owning the project. Currently, the project company is owned by affiliates of Sithe Global Power LLC. However, it is anticipated that the Government of Guyana will acquire a direct or indirect ownership interest in the project company. The EPC contractor is China Railway First Group Ltd. (a Chinese state-owned enterprise). The project will be owned and operated by the sponsors for 20 years, after which it will be transferred to the Government of Guyana through a Build-Own-Operate-Transfer (BOOT) arrangement.

CDB and Inter-American Development Bank ("**IADB**") will provide loans to the project company and the proceeds under the PPA agreement between the project company and Guyana Power Light, as power purchaser, will be used for repayment of loans to the lenders.

We are representing China Export & Credit Insurance Corporation ("**Sinosure**") in this project regarding its issuance of commercial and political insurance in relation to the facility granted by CDB in this project. Our representation included advice on sophisticated commercial structure for the single-offtaker project, Sinosure's insurance policy, project documents, financing documents and other related issues.

This project is one of the longest negotiated power plant project in South American history. Discussion was initiated back in 1997 but was not finalized until 2010 because of various political and environmental issues. This project is due to commence work in late 2011.

Project particulars

Contract Value:	**~US$700 million**
Sponsors:	Sithe Global (and Guyana Government)
Contractor:	China Railway First Group Ltd.
Lenders:	CDB and IADB
Insurer:	Sinosure

The Minton – Condominium development in Singapore (~S$300 million)

This project comprises the design and build of 18 blocks of condominiums with car parks, swimming pools and communal facilities in Singapore with a land area of approximately 470,000 square feet. Qingjian Group Co. Ltd (through its Singapore branch) ("**Qingjian**") is the main contractor in this project.

CDB as lender granted a 3-year term loan facility in the amount of S$120m to Qingjian in China. The facility is secured by a Deed of Charge granted by Qianjian in favour of CDB over certain bank accounts, receivables and benefits under insurance policies in Singapore and elsewhere, whereby all the proceeds and receivables from this project are effectively charged to CDB as security.

We acted for CDB in this project and advised on, amongst other things, the legality of the Deed of Charge, particularly whether the charge over bank accounts and receivables in Singapore is compliant with Singapore law and regulations, and other tax and regulatory issues.

This financing deal was successfully completed in 2011 and our representation was well-received by CDB. We are now advising CDB on another financing transaction of a similar scale and with similar issues.

Project particulars

Contract Value:	**S$296,641,153**
Employer:	Peak Garden Pte Ltd
Contractor:	Qingjian
Employer's Lender:	United Overseas Bank Ltd
Insurer:	CDB
CDB Loan Value:	S$120m (~RMB$600m)

Alberta First Nation Energy Centre in Alberta, Canada (~CN$6-8.5 billion)

This project comprises construction and operation of a 125,000bpd greenfield heavy oil sand upgrader and refinery in Alberta, Canada, under the project name of Alberta First Nation Energy Centre. The estimated capital costs for the project is around CN$6-8.5 billion. With the mandate of the Government of Alberta, Teedrum Inc. and Alberta First Nation Energy Centre Holdings GP are expected to be the key shareholders in this project (the "**Sponsors**").

The Sponsors are searching for suitable strategic partners (a) to provide financing through the combination of both equity and debt components; and (b) to manage and operate the project under (i) a Bitumen Royalty-in-kind Agreement ("**BRIK**") whereby the Government of Alberta will collect a fixed amount of conventional crude oil production in kind as royalties for the project; and (ii) a Crown Bitumen Supply and Market Agreement for cash royalties in respect of any excess supply of bitumen.

The Sponsors have approached entities of the governments of India and China for proposals. In particular, the Sponsors are in touch with China National Technical Import and Export Corporation ("**CNTIC**") as potential contractor, and CDB as potential financier.

This project is currently in the design and negotiation stage. The estimated time for commencing work is in June 2013 and operations are expected to begin in 2015. If CNTIC successfully closes this deal with the Sponsors, this will be the largest heavy oil sand refinery project involving China in Alberta (the last investment was made by SINOPEC for a 9% stake in Syncrude Canada Limited for CN$4.6 billion in 2010).

We have had several rounds of meetings with CDB and CNTIC, the potential strategic partner, for an engagement in this project. An initial project due diligence list has been provided to CDB and CNTIC.

Project particulars

Contract Value:	**CN$6-8.5 billion**
Sponsors:	Teedrum Inc. and Alberta First Nation Energy Centre Holdings GP
Potential Strategic Partners:	CNTIC
Employer's Lender:	United Overseas Bank Ltd
Potential Lender for the Strategic Partners:	CDB

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Japan Infrastructure Update

By Craig Brook (Associate, Singapore)

The year 2011 will certainly go down in the history books for Japan, after:

- the government officially announced in February 2011 that the Chinese economy had overtaken its own as the second largest in the world, a title which the country had held since 1968;
- a magnitude 9 earthquake and a resulting tsunami, which struck the Fukushima prefecture in March 2011, which killed more than 15,000 people, displaced over 100,000 people from their homes and caused a chain of events that led to the world's biggest nuclear disaster since the Chernobyl disaster in 1986;
- the country's economy officially slipped back into recession in May 2011, having previously reported some promising results, particularly in relation domestic to GDP and growth, towards the end of 2010;
- Moody's, citing weak economic growth prospects, frequent changes of government that prevent long-term budget planning and a build-up of debt, officially downgraded the country's sovereign debt rating, by one step, to Aa3, in August 2011;
- former Prime Minister Nato Kan announced his resignation in August 2011 and was replaced by Yoshihiko Noda shortly thereafter, who became the country's sixth leader in just five years;
- a powerful typhoon passed over the Japanese mainland in September 2011, killing 12 people and leaving a trail of destruction in its path; and
- the Japanese government has been forced to intervene in currency markets, on three separate occasions and at an estimated cost of almost 100 billion Yen, in order to tame a surging Yen.

On the back of all this, one could certainly forgive those, both within the private and public sector, who have "written off" 2011 (despite the fact that we still have some two months to go) and who have already started to look to 2012 and beyond.

It has not all been bad news stories this year for Japan, however, in the infrastructure space.

The fact that China, Japan's largest neighbour, is booming is good for Japan, as much of the economic growth in these countries and throughout Asia is being fuelled by foreign investment and, in particular, the construction, manufacturing and technology knowledge and expertise of countries such as Japan.

Design and construction of the locomotives and other technologies for the recently opened high speed rail link from Shanghai to Beijing, is a good example of a project in China, which was heavily reliant on Japanese investment, knowledge and expertise. It has been recently reported that by 2015, through continued expansion of its high speed rail network, China will have more high speed railway track than the rest of the world combined and the construction of the further infrastructure required in China to bring this ambitious plan to life, will bring with it continued investment opportunity for Japanese organisations.

Additionally, the continued development of PPP and other project delivery frameworks in developing countries, such as Indonesia, Vietnam, Mongolia and India, all of which are key trading partners with Japan and are locations where many Japanese entities have established offices and have been working for many years, combined with an increased urgency and desire from governments in many of these countries to deliver economic and social infrastructure projects, in order to meet the needs of a fast-growing and increasingly wealthy populations, will also present further outbound investment opportunities for the Japanese private sector.

The devastation and continued fall-out caused by the nuclear disaster at Fukushima Daiichi nuclear power plant in March 2011, has also caused a paradigm shift in thinking, both within government and amongst the general population, in relation to the virtues of nuclear power.

In August 2011, the Japanese parliament passed new laws, establishing a new feed-in tariff scheme, in order to

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encourage a greater reliance within Japan on renewable sources of energy, and which will require Japanese utility companies to source electricity generated from solar, wind, biomass, geothermal and small-sized hydro power plants, at pre-set rates, for up to 20 years. Whilst there are still many questions marks around what the additional cost impacts of these new laws will be, the current Japanese government has publicly announced that it wants its new feed-in tariff scheme to boost capacity of these five renewable energy types by more than 30,000 megawatts by 2021.

Solar and geothermal energy are likely to be the most important sources for a country such as Japan, with a string of newly opened power plants, such as the Japanese-owned new 10 megawatt solar power plant, which has this year started commercial operations in Osaka, and the development of other, new renewable projects, central to the Japanese government's overall plans to both reduce the country's reliance on nuclear energy and to stimulate it fledgling domestic economy. Japanese organisations were once global leaders in developing more efficient solar technology (before being overtaken by countries such as Germany, at the turn of the last century) and many, both within Japan and beyond, are hoping that they can return to these lofty heights, as more efficient solar technologies continue to emerge around the world and the cost of solar power continues to fall.

Furthermore, as a result of an increased local demand for imported LNG, natural and other “clean” gas products (the appetite for which has also become even greater in Japan, over the past six months, as a result of Japan's preference for cleaner, safer sources of energy), Japanese construction, technology and utility companies have also been quietly increasing their involvement in all aspects of a number of LNG and other similar projects throughout the Asia Pacific region and the Middle East. Japanese organisations have key roles, for instance, in the construction of, and as consumers of LNG to be produced at, two new onshore LNG facilities in Australia and in the development of Indonesia's first floating LNG project.

What can we take away from all of this? As a result of the events of 2011, and as we move into 2012 and beyond, there is no doubt that Japan must re-invent and re-establish its economy. Some would even say (and have in fact publicly said) that this is well overdue, with a reliance on fledgling domestic growth alone not enough for Japan to remain relevant as a global economic power well into the 21st century. Continued investment in new infrastructure projects fuelled by economic growth, by Japanese organisations, is absolutely crucial to the development of other countries throughout Asia. And combined with a continued commitment to invest in alternative sources of energy by Japanese organisations, growth in the infrastructure sector is also an important part of the solution to the major challenges faced by the current Japanese government.

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World Bank-Singapore Infrastructure Finance Summit 2011

The third annual gathering of leading global and regional infrastructure policy-makers, investors, contractors and strategists saw the signing of a landmark agreement between the World Bank Group and the Government of Singapore, by World Bank President, Robert Zoellick, and Singapore Deputy Prime Minister and Minister for Finance, Tharman Shanmugaratnam.

The agreement makes Singapore the World Bank's knowledge and financial activities hub, and the first combined World Bank Group office of its kind outside Washington D.C.

The signing of the agreement was one of the highlights from Asia's premier infrastructure conference, the World Bank – Singapore Infrastructure Finance Summit in association with the Financial Times and the World Bank-ASEAN Infrastructure Finance Network, with support from the Australian aid agency, AusAID. For the third year running, Hogan Lovells played a significant role at the Summit.

Held at the InterContinental Singapore on 6 September 2011, the Summit provided a forum to debate and generate innovative public-private solutions to fund and implement key infrastructure projects. The role of the region's still underdeveloped capital markets in infrastructure financing, and in particular the creation of an effective municipal bond market in Asia, was a major focus of discussion at the Summit, attended by more than 300 high level government officials and private sector representatives from East Asia and beyond.

Singapore Office Managing Partner and the Asia Head of Hogan Lovells Infrastructure Practice, James Harris, joined a panel of experts to debate the merits of some of the most interesting infrastructure projects being developed in Asia, across Vietnam, Indonesia and China.

The World Bank Group's agreement with Singapore will increase the focus on solutions to address urban development challenges, infrastructure financing, information communications technology and accounting and auditing services. The expanded World Bank Group presence includes the IFC – the largest provider of multilateral financing for the private sector in developing countries and one of Hogan Lovells' key clients – and the MIGA – the Bank Group's agency which provides political risk insurance. The Singapore office will increase to a staff of about 70.

The World Bank Urban Hub and Infrastructure Finance Center of Excellence are already supporting innovative projects across the region, including the securitization of future toll road revenues in China, public-private partnership in water supply and treatment in Indonesia, and urban transportation planning in Vietnam. On many of these projects Hogan Lovells has a lead legal advisory role.

IFC will draw on Singapore's strong private sector experience to support the scale-up of critical infrastructure projects in developing Asia and will seek to partner with Singapore-based firms to invest in emerging markets around the world.

MIGA views Singapore as a center for insurance and looks forward to working more closely with the government as well as public and private sector entities to share knowledge and experience. The agency's scaled-up presence will assist Asian investors to facilitate their plans for inbound and outbound investments.

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Indonesia reinstates Government support letter scheme for IPP projects

By Justin Patrick (Associate, Singapore)

Indonesia's Minister of Finance, in August 2011, issued a regulation (Minister of Finance Regulation No. 139/PMK.011/2011) that enables the issuance of a "business viability guarantee" letter in favour of certain independent power producer ("**IPP**") projects being implemented under the Indonesian government's second "fast track" power generation program. Eligibility for the guarantee letter is based on a proposal from PT PLN (Persero) (Indonesia's state-owned electricity company and the offtaker under such projects) to the Minister of Finance, based on substantive and administrative requirements specified in the regulation. Geothermal IPPs are eligible for the guarantee letter if the IPP is established by the winner of the tender of a geothermal working area or the IPP entered into a Power Purchase Agreement ("**PPA**") (commonly referred to in geothermal projects as an energy sales contract) with PLN prior to the enactment of Law No. 27 of 2003 on Geothermal, ie, those projects being implemented pursuant to a joint operation contract with PT Pertamina Geothermal Energy (a subsidiary of Indonesia's state-owned oil company, PT Pertamina (Persero)). These requirements indicate that pre-existing geothermal projects are eligible for such guarantee letters. Projects other than geothermal IPPs are also eligible for the guarantee letter if the project has not yet been tendered by PLN or the project has been tendered and a winner has or has not been appointed, in each case prior to the regulation's issuance. The regulation's requirements indicate that non-geothermal projects that have advanced from the appointment of a winning bidder (eg, those with a signed PPA) after the regulation's issuance are not eligible for such guarantee letters.

The "business viability guarantee" letter is to cover the risk of non-payment by PLN for amounts stated in a payment invoice in respect of the purchase of electricity issued by an IPP in accordance with the applicable PPA. The regulation does not clarify whether such a guarantee is intended to cover the risk of non-payment by PLN of amounts due on the PPA's termination (for example, in the event that PLN is required to purchase the project due to PLN's non-remediable default). Additionally, the regulation provides that the risk of non-payment only relates to invoices issued after the project has commenced commercial operation (until either the expiry of the PPA or some other date stipulated in the guarantee). Consequentially, coverage under the guarantee may not extend to invoices for electricity generated during the start-up and commissioning of the plant. The regulation does not provide further details regarding the form or content of the guarantee, except that it is to be set forth in a letter signed by the Minister of Finance and addressed to the IPP.

These guarantee letters are to become ineffective if the IPP fails to reach financial close (ie, signing of loan documents and initial drawdown) within 48 months of the issuance of the applicable guarantee letter, in the case of a geothermal IPP, and within 12 months of the issuance of the applicable guarantee letter, in the case of a non-geothermal IPP. There is no mechanism for these periods to be extended, and the guarantee letter is to be issued either simultaneously with or after the signing of the PPA. However, for an IPP being implemented in accordance with Indonesia's public-private partnership ("**PPP**") regulations – and therefore eligible for support from the Indonesia Infrastructure Guarantee Fund ("**IIGF**") (described below) – the IPP would nevertheless be required to reach financial close within 12 months of the signing of the PPA (subject to extension of up to an additional 12 months by PLN, if the failure to reach financial close is not due to the IPP's negligence), or risk termination of the PPA and forfeiture of the IPP's performance bond.

The availability of a "business viability guarantee" letter issued directly by the Indonesian government may significantly enhance the bankability of Indonesian IPP projects and contribute to their resurgence. Indonesia's "first generation" of IPP projects – those implemented prior to the Asian Financial Crisis – benefited from a government support letter, signed by the Minister of Finance, which essentially provided that the Indonesian government would cause PLN to discharge its payment obligations under the PPA and would submit to international arbitration in the event of any dispute in relation to the support letter. Although these support letters did not constitute a guarantee of PLN's payment obligations, they were perceived as indicating sufficient government

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support to make these early projects bankable and to provide a basis to involve the government in an arbitral dispute.

In more recent years, however, the Indonesian government has indicated reluctance to provide direct government support to IPP projects. In lieu of providing direct government support in favour of the private sector, in 2006, the government entered into the JBIC Umbrella Note of Mutual Understanding, an agreement with the Japanese Bank for International Cooperation ("**JBIC**") intended to provide a basis for the Indonesian government's support of IPP projects benefiting from JBIC export credit support. More recently, the Indonesian government has established the IIGF, a state-owned enterprise intended to provide credit support for a ministry or agency of the central government, state-owned enterprise (such as PLN), regional government or region-owned enterprise that acts as a procuring party in connection with a PPP for infrastructure delivery. IPPs are also considered eligible for IIGF support. The first IIGF Guarantee Agreement (with the Indonesian government acting as co-guarantor) was issued for the Central Java IPP project (2x1000MW) on 6 October 2011.

Although an IIGF guarantee does not provide direct recourse to the Indonesian government, the regulatory framework applicable to IIGF provides that for larger projects – those for which the IIGF's capital is insufficient – the Indonesian government may act as a co-guarantor, with the IIGF acting as administrator of the joint guarantee. The "business viability guarantee" regulation, however, does not include any reference to IIGF, as administrator or otherwise. Consequently, this regulation may be intended to allow IIGF to focus on PPP projects in other infrastructure sectors, while the Ministry of Finance takes a more direct role in IPPs. However, if the "business viability guarantee" letter does not cover PLN's payment obligations on a PPA's termination, the continued involvement of IIGF (possibly acting with the government as co-guarantor) may be considered necessary in some cases. The Ministry of Finance's risk management unit evaluates both proposals for the Indonesian government to act as a co-guarantor with IIGF and proposals for a "business viability guarantee" letter under the recent regulation.

Minister of Finance Regulation No. 139/PMK.011/2011 supersedes Minister of Finance Regulation 77/PMK.01/2011, which provided for a support letter to be addressed to PLN, rather than the IPP. Further information regarding the government's second "fast track" power generation program is set forth in Presidential Regulation No. 4 of 2010 regarding Designation to PT Perusahaan Listrik Negara (Persero) to Carry Out Acceleration of Development of Electricity Generators that Utilize Renewable Energy, Coal and Natural Gas and Minister of Energy and Mineral Resources Regulation No. 15 of 2010 on List of Projects for the Acceleration of Development of Electricity Generation Using Renewable Energy, Coal and Gas and related Transmission.

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A tidal change in the ability to obtain injunctive relief in arbitration? The new ICC Rules

By Chris Cross (Partner, Dubai)

When a western contractor was involved in a dispute with a local UAE based employer earlier this year regarding the construction of a jackup rig, the contract stated that all disputes under the contract must be referred to arbitration. Faced with a situation where it had completed works, it had not been paid; and the employer was looking to remove the rig from UAE waters to the place where it was to be situated, the contractor was faced with a difficult predicament of how to ensure it obtained payment before the rig departed for international waters.

In the end, the contractor had no choice but to turn to the unknown waters of the local courts to obtain an injunction prohibiting the rig from leaving port.

One complaint arbitration users commonly raise with the arbitration process is how to deal with issues that need quick resolution such as applications for freezing injunctions etc. No arbitration centre has yet provided a mechanism to deal with this where parties have adopted arbitration dispute resolution clauses.

However, on 12 September 2011, the International Chamber of Commerce issued a revised version of its Rules of Arbitration. This followed a rigorous consultation process commenced in 2008 led by a Task Force of over 175 arbitration practitioners, including members of Hogan Lovells, from 41 jurisdictions. The new rules will come into force on 1 January 2012 although parties can agree to have the new rules incorporated into their arbitration provisions.

The new Rules maintain the general and flexible approach to arbitration procedure, so that it is capable of adapting to disputes of a different type and amount and to parties from different legal backgrounds. The new Rules also preserve the main distinctive features of ICC arbitration, such as the Terms of Reference, the role of National Committees in the appointment of arbitrators and the scrutiny of the award, among others.

Chris Cross, the Head of Hogan Lovells Projects, Engineering and Construction practice in the Middle East comments that:

"*The ICC is one of the centres of choice for parties entering into construction projects in Asia. In 2009, approximately 45% of the 817 cases filed with the ICC involved engineering, construction or natural resource extraction project disputes. Of those 817 cases, 589 parties subject to those arbitrations were from the MENA/Asia. Consequently, the ICC is an extremely popular choice for parties involved in projects and with MENA/Asian based parties. The revised rules will only help fuel the ICC's popularity.*"

The most significant change is the introduction of the Emergency Arbitrator, who may be appointed at the request of a party applying for urgent interim or conservatory measures that cannot await the constitution of the arbitral tribunal. The Emergency Arbitrator, having heard the parties, may make an order, which the parties agree to observe.

An application for such an order can be made at any time before the file is transmitted to the tribunal, even before the Request for Arbitration is submitted. Once the arbitral tribunal is appointed, it may modify, terminate or annul the orders made by the Emergency Arbitrator.

The Emergency Arbitrator Rule will not apply to arbitration agreements signed before the entry into force of the new Rules or where the parties have agreed to opt out of it or have agreed to another pre-arbitral interim measure mechanism.

Mark Davison, an Associate in the International Arbitration practice in Dubai states that:

"*There is often apprehension from western based clients from entering Asian and Middle Eastern courts. This is for many reasons such as: the fact that the court processes are foreign to them; and the fear that the courts may favour local parties. However, if a client needs to obtain immediate injunctive relief, it will often face no choice but to tackle these fears and enter the local courts. The use of the new ICC Rules should help to alleviate this problem for foreign contractors operating in the region.*"

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Whilst in the story above the western contractor was ultimately successful in obtaining its injunctive relief, the new ICC rules could have helped it to tackle this problem in waters in which it was common and comfortable with

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Middle East Regional Update – Qatar

By Chris Cross (Partner, Dubai)

This article is the first of a number of Middle East regional updates that will be provided in the AIG newsletter. Our team in the region (based in Dubai, Abu Dhabi, Jeddah and Riyadh) has significant experience of working in a number of countries in the Middle East, and in particular Qatar. This article focuses on the current infrastructure work that Qatar is proposing to undertake and the challenges that will need to be overcome for the projects to be successfully delivered.

In terms of infrastructure, when most people think of Qatar they now think of the FIFA World Cup tournament which will be held there in 2022 (the "**World Cup**"). However, even before the World Cup award there were significant moves afoot to upgrade the infrastructure in Qatar, and in particular Doha. In 2008 a decree was issued approving the comprehensive development vision 'Qatar National Vision 2030' (the "**Vision**"). The ambitious aim of this development vision was the transformation of Qatar into a first world country that relies on sustainable development. The vision has four pillars: social, economic, environmental and human development. As I write this article the current approved planned projects have a total estimated budget of over $188.6 billion and more than 63% are for Infrastructure and construction[1]. Hosting the World Cup has accelerated target completion dates of many of these planned projects and there is rightly a great deal of interaction and overlap between the projects required for the World Cup and the Vision.

The requirements for the World Cup and the Vision are in many cases still at an outline stage, which will have a knock-on effect on deliverability and the cost of the works. The World Cup itself has a budget of anywhere between US$88 billion and US$120 billion depending on which local sources you speak to (and whether all of the planned projects are undertaken). It is clear that although there was an infrastructure development plan in place to allow Qatar to compete in the bid it was by no means complete, and the infrastructure, logistical and support requirements appear to be still being identified, designed or re-designed to meet the practical requirements of the World Cup and to fit in with other infrastructure works being undertaken in Qatar. What is certain is that these projects need to be substantially completed by 2012 and operating before 2022.

Key Projects (World Cup and 2030 Vision)

- Doha Metro Network (estimated cost US$25 billion);
- Roads and Bridges Network (estimated cost US$20 billion);
- Hotels and tourism-related infrastructure (estimated cost US$17 billion);
- New Doha airport (estimated cost US$13 billion);
- New Doha sea port (estimated cost US$5 billion);
- 12 stadiums (nine new and three renovated) (estimated cost US$5 billion);
- Qatar – Bahrain Friendship Bridge (estimated cost US$4 billion);
- Doha Bay crossing project;
- a long distance rail network (linking Saudi Arabia and Bahrain);
- West Bay People Mover (underground system);
- Lusail Light Rail System;
- Education City Light Tram;
- three hospitals (1303 beds) (estimated cost US$3 billion);
- 31 new schools and the upgrading of 49 existing schools (estimated cost US$400 million); and
- the creation of Education City (estimated cost US$1.3 billion).

This is an impressive list of infrastructure requirements, which need to be met in a relatively short timescale. The sheer size of the programme has raised questions amongst many contractors for a number of reasons (which we go into further detail below), but not least being capacity to undertake the work, and there is a current perception that a number of these projects will ultimately be postponed or fall away once Qatar has identified the priority schemes. One key project already in development is the Doha Metro. Over 35 consortia have reputedly put in expressions of interest for the six design and build work packages that have been issued as the first stage (principal infrastructure) of the metro procurement, and the market will be watching closely to see how the Qatar government handles the procurement. Another sector where contractors are watching with interest is power and water. Currently Qatar has a generation capacity of 9051 MW and

[1] Source: MEED

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327 million gallons per day for power and water respectively[2], but peak demand is well below these figures. Qatar's current view is that peak demand will grow sufficiently (10-12% per annum) to require further power and desalination plants to come on stream, but the view of some international contractors is that any extra demand required will be principally for the FIFA World Cup and associated infrastructure on a short-term basis rather than for a long-term need for additional power and water for the local population.

Paying for the Projects

The state budget allocations for 2010/2011 demonstrate Qatar's proprieties, but also identify the need for project/ contractor finance for a large number (if not all) of the World Cup (and indeed Vision 2030) projects. For this period the predicted total revenues are US$35 billion and the total expenditure is US$32.4 billion. The expenditure for infrastructure is set at QR35.5 billion (US$9.7 billion or 30% of budgeted expenditure). Whilst this is clearly impressive, Qatar will not be able to pay cash for the projects and third-party finance will be required. Credit acceptability of the procuring entity will be a key issue. It is unclear who the procurers will ultimately be at this stage but the local view is that the credit rating of Qatar and the relative strength of the sponsors (the government) should make financing these projects an attractive option. Given that Qatar is a civil code-based jurisdiction (and therefore sovereign immunity applies) it is not clear how much thought has yet been given to the concerns of funders or indeed contractors regarding what will make the projects bankable.

Key Contractor Concerns

Key Contractor concerns are likely to be:

- security packages – current local thinking is that traditional project/contractor financing models will be used. If "traditional" construction finance models are used and contractors are required to provide significant bonding for advance payments and performance, then contractors may end up being severely restricted in terms of the projects they can bid for due to the effect on their available bonding lines;
- type of contracting – it is unclear whether all of the World Cup and Vision 2030 projects will be procured on a similar basis to the Doha Metro (D&B work packages followed by subsequent operational/technical procurements) as there has been much local discussion about the use of hybrid PPP models. Lack of clarity with regard to risk and to procurement models may delay the projects and mean that contractors are unwilling to accept risks they would ordinarily do in a more developed market;
- lack of regulation and familiarity with Islamic civil law jurisdictions – an issue for some international contractors will be that commercial issues are covered under the Qatar Civil Law (Law number 22 issued in 2004, based on the Egyptian Civil Code) where key issues, such as limits on liability – a contractor will be unable to limit its liability for negligence or gross mistake and contractors and designers are jointly and severally responsible for structural defects under the decennial liability provisions – are not always dealt with in the way that international contractors prefer or are used to. The Qatar Civil Law itself is principally a framework around which additional more specific local laws are required to provide contractors and investors comfort that they are working in a clearly regulated environment. There are 24 provisions relating to works contracts in the Civil Law (Chapter III), which is an advance on the Egyptian position but many of these provisions conflict with the standard form construction contracts (principally based on the FIDIC Red Book (1987 edition)) used, and there is little else in terms of local law to clarify the situation or other issues relating to infrastructure projects;
- limited ability to negotiate contract terms – in practice there are far more limited opportunities to substantially renegotiate contract terms than in other jurisdictions so greater emphasis will need to be placed on alternative methods, such as insurance and the contract management process, to mitigate risk. This is likely to add cost to an already expensive bid process, which will in turn lead to a more cautious approach by bidders;
- availability of finance – the use of project/construction finance models should provide a healthy tranche of business for banks but there are concerns regarding the availability of finance (both Islamic and conventional) in the local market. Whilst there are a significant number of financial institutions in Qatar (there are over twenty banks in the Qatar Financial Centre alone) there are restrictions on the loan to deposit ratio (90%) and most banks have reached the ceiling. For the increase in loans required to cover these projects to be allowed there will need to be a relaxation of a number of regulations. It should also be

[2] Source: MEED

noted that where Islamic finance is required this can only be provided by local banks as the Qatar Central Bank issued a decree requiring conventional finance providers to close their Islamic finance units by the end of this year;

- intercreditor issues – there is a clear push towards multi source funding for these projects, including the use of ECAs and Islamic finance, so time will be needed to solve possibly complex intercreditor issues; and
- local partnerships – a key to successful contracting in Qatar has traditionally been the development of strong local partnerships. Given the number of international bidders interested in these projects those that do not already have these partnerships in place may find bidding a difficult process.

Conclusion

The FIFA World Cup and the 2030 Vision are impressive infrastructure programmes which should allow Qatar to achieve its aims. It is clear that there is still some way to go in determining how much of this grand strategy can or will be achieved within the timeframes, but Qatar has the resources and the commitment to succeed. For international infrastructure contractors this is an attractive and lucrative new market with a sustained deal flow, but there are a number of local issues they will need to consider and resolve before they throw their hat into the ring.