OPINION

'Comfortable, relaxed' infra projects

by DOUG JONES

ONLY 10 years ago the provision and funding of public works and services by the private sector was something of a novelty in Australia. Today it is a widely accepted part of the political landscape - and is likely to continue to be a major source of work for the construction industry in the future.

This "m-turing" of private sector infrastructure has been accompanied by some interesting shifts in the willingness of local and international debt and capital markets to fund major Australian projects and take on their risks, many continuing for decades.

The risks of greatest concern to financiers are whether the project revenues will be sufficient to repay debt, political and regulatory risks, operating risks, *force majeure* and the handling of defaults and termination of the project contracts. In the last few years there have been significant movements in almost all these areas.

In part this reflects the fierce competition for most infrastructure projects, allowing governments to run competing consortia and their financiers "to the wire" in negotiating project contracts. What is less clear is whether the changes in financiers' attitudes reflect a wider willingness to take on risks in major projects, or are merely an artifact of the powerful bargaining position of governments during the 1990s.

Of course, even if governments continue to wield this power, project financiers have a well-deserved reputation for thinking laterally, so there is no guarantee their attitudes will be the same in the new millennium. Their traditional approach, early in the 1990s, was to insist that infrastructure projects should be insulated from demand and price risks by locking in long-term sales contracts.

Most commonly this took the form of a "take or pay" contract, with the purchaser (of the electricity, water or whatever) being obliged to pay a minimum amount, sufficient to cover operating costs and debt repayments, regardless of whether it took the product.

This is a far cry from the position today.

In the disaggregation of the electricity industry in several states, for example, financiers have been prepared to take on the full market risks now faced by electricity generators, with hedging available only from other market participants, some of dubious long-term credit quality.

Similarly, project sponsors and financiers have taken on the full market risks in major toll road projects, with only limited protections concerning alternative forms of transport, typically through renegotiation of the contracts if the government's future development of other roads and public transport has a demonstrable material adverse effect on the project.

At the other extreme, financiers are still unwilling to accept market or demand risks where a government is purchasing the services and there is no real "market". On privatised prison projects, for example, debt servicing is typically protected by a "facilities availability" charge, on top of operating fees.

For overseas projects these risks quite often extend to civil disturbances, revolutions, expropriation and nationalisation. In Australia, they are more mundane, focussing on changes to laws, including tax and environmental legislation, and changes in government policies.

The most obvious policy risk might initially appear to be the later election of a government opposed to privatisation. But a gung-ho privatisation policy carries its own risks: the government-owned, government-guaranteed entity with which a sponsor has contracted might later be replaced by a highly geared new private company.

A decade ago it was common to attempt to cocoon a project from political and regulatory changes by obtaining a support agreement from the government, preferably "entrenched" in legislation. This approach is now very much out of favour with governments.

Instead, project sponsors and financiers are generally willing to accept regulatory risks, especially in the water, electricity and gas industries, if a genuinely independent regulator has been established, at arms length from the government.

Fierce battles common during contract negotiations

Again, a decade ago it was common for fierce battles to be fought during contract negotiations on "change of law" provisions. State governments were unwilling to accept any risks of Commonwealth changes of law, while sponsors and financiers believed they too should be insulated from these risks, or at least that the risks should be shared.

Today, this situation is changed in some cases but not in others.

On the Melbourne City Link project, for example, there is a sharing of the risks of both Commonwealth and state changes of law which discriminate against the project or do not affect businesses more generally, through possible renegotiation of the contracts if there are material adverse effects on the project.

In other, more recent projects, however, state governments have still refused to accept the risk of changes to Commonwealth laws, other than pricing adjustments associated with the GST.

And while financiers now generally accept the adequacy of state government obligations not to change state laws so as to discriminate against a project, in one recent case a state government refused to provide even this basic level of protection.

Over the last five years financiers have loosened the reins a little when it comes to operating risks. In general, they seem more willing to strike a workable balance between their own concerns and allowing the project sponsor to carry on its business - especially when the sponsor has proven expertise and the financiers have a sound understanding of the relevant industry and thus the project's financial modelling.

In these cases, financiers are no longer insisting on being involved in every significant business decision affecting the project. In some instances they have also been prepared to forego their control over the project's cashflows, by no longer insisting on the payment of all revenue into special purpose accounts for which debt servicing had priority over everything except operating costs.

But project financiers still insist on being involved in decisions affecting risks which a government has required a sponsor to bear regardless of the sponsor's expertise. And when it comes to the risks of operator failure or default, government attitudes have hardened over the last few years.

Governments are now reluctant to ensure, as they once might have, that debts will be repaid or that buy-back prices will reflect these debts if a default leads them to resume the project. In general, however, but not always, some form of compensation is still payable by the government, usually based on market value less deductions.

These days, project sponsors and financiers are generally more comfortable with the handling of insurable *force majeure* risks, especially if the project's term is able to be extended.

Comfort levels are obviously lower when it comes to accepting the risks of uninsurable *force majeure* events. But clear recognition of the types and probabilities of these events, coupled with an ability to extend the term of the project, are winning increasing acceptance.

The biggest change in attitudes to *force majeure* has been the acceptance by financiers of government requirements for damaged or destroyed infrastructure to be reinstated, so the public service may be continued. No longer are financiers generally free to decide whether insurance proceeds should be applied to debt repayments ahead of reinstatement works.

This is the one area where there has been little movement over the last few years. Default and termination provisions are as hotly debated as ever.

Sponsors and financiers are still concerned, quite justifiably, to ensure that:

- Defaults triggering termination rights are confined to those significantly affecting the project
- "Cure" periods are available, and
- At the end of the day, governments cannot easily walk in and take back the infrastructure for little or no consideration, reaping a windfall gain.

Ed.: Doug Jones AM is a construction partner in the national law form Clayton Utz

PEOPLE

■ Consulting engineering firm Norman Disney & Young has appointed **Ashak Nathwani** as director in charge of its Canberra office. Nathwani has been working in the ACT with the firm's Y2K division, Engineered Solutions Australia, which has carried out Y2K projects for federal government departments. As well as being a director of NDY, he is co-director of Eco Sustainable Solutions Australia, a jv with environmental and design management specialist Karla Bell & Associates.

Ashak Nathwani ... new NDY Canberra chief.

■ **The Specialised Carriers and Riggers Association (SCRA) has elected Delynn Burkhalter, ceo of Burkhalter Rigging in the US, as its chairman. Burkhalter has served this international association, based in the US, as its president, vp, assistant treasurer, chairman of the Crane & Rigging Group, and chairman of the Crane Permit Task Force. He also serves the board of directors of the SC&R Foundation. SCRA has elected as its president Donald Russell, president and ceo of Sheedy Drayage in the US. Russell has served the association as vp and as a member of the association's crane and lifting group governing committee, crane and rigging safety committee and special task forces.**

■ Residential property developer Australand has appointed **Susan Pearse** to the position of Queensland customer care manager. Pearse has worked in customer care management with an international cosmetics company and a national courier and logistics company.

Susan Pearse ... customer care manager.

■ *Interflow, based in Sydney, has appointed **Ian Knabel** as a business development manager for its new office at Nunawading in Victoria. Knabel has been involved with Naylor Clayware sewer pipes and he has joined Interflow after 11 years with CSR Humes.*

■ Industrial equipment and components manufacturer Ingersoll-Rand has appointed **Peter Hong** to the position of vp and treasurer. Hong comes to Ingersoll-Rand from CNH Global, a company created by the business merger of Case Corporation and New Holland, where he was responsible for investor relations and business development. In his new position, he will be responsible for all corporate finance functions.

■ **Glynwed Pipe Systems Australia has appointed Yvette Gasparin to**