

Bird's eye view

Norton Rose Fulbright's Raquel Bierzwinsky and Rachel Crouch look at the region's key projects, environmental and social impact issues and the rise of Chinese involvement

What have been the most important energy projects or programmes across the region over 2017-18?

Renewable energy continues to be an important focus for project finance across the region. Particularly active markets in 2017 and 2018 are Mexico, Brazil, Chile and Argentina.

For several years, Mexico has made renewable energy a priority. It aims to increase electricity generated from clean energy sources to 35% by 2024 and 50% by 2050. Since its 2013 energy reform, Mexico has run three rounds of long-term clean energy auctions, awarding nearly 20 TWh of energy, nearly 1.8 GW of capacity, and more than 20 million clean energy certificates. Several projects from the first two rounds have reached financial close, with third-round projects currently seeking capital. Enel's 754 MW Villanueva solar plant in the state of Coahuila will be the largest solar plant in Latin America. Acciona's 183 MW El Cortijo wind farm will be the first power plant from the auctions to start operations on September 1 2018, followed closely by Enel's power plants and Cubico/Alten's Solem 1 and Solem 2 solar power plants. The Solem power plants may be seen as one of the most noteworthy renewables projects in the region over 2017-18, as these are among the first of the projects with PPAs under the new auction framework to reach financial close and commercial operation, providing important evidence of the bankability of the Mexican PPAs.

Brazil has shown a similar commitment to renewables and aims to meet 45% of its energy demand with renewables by 2030. Its recent economic crisis has resulted in more fitful development of renewables, but it held new auctions for capacity in December 2017, which resulted in the first contracts for wind and solar projects for several years.

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Argentina, which has lagged behind many other Latin American countries when it comes to project development in renewables, has committed to meeting 20% of its energy demand with renewables by 2025. It has conducted two rounds of auctions under its RenovAr program to date, with the third round expected later this year. A few projects that have been awarded long-term PPAs in the first few rounds have secured international project financing, which is remarkable for a country that had not seen a long-term, limited recourse project financing of an energy project in over a decade.

Have these energy generation projects implied any associated development work?

Along with new power sources in the region comes the need for improved transmission. This issue has been particularly acute in Chile, where solar projects in the north of the country have faced trouble transmitting power to the more highly populated south. Both ISA's

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Cardones-Polpaico transmission line and Engie's TEN transmission line will relieve a significant amount of the glut and there are other transmission lines under construction. Mexico shares a similar situation, with a very significant need for transmission infrastructure in the North and South of the country.

Mexico's Ministry of Energy (SENER) is working to interconnect Mexico's National Interconnected System with Baja California's state grid, which is not interconnected to the national grid and is only interconnected to California's state grid. The project is structured under a design, finance, build, operate and transfer (DBFOT) model and entails a DC-transmission system with an estimated length of 1,400 circuit kilometres at a voltage level of ± 500 kV and a total transmission capacity of 1,500 MW. The estimated investment for this project is approximately \$1.1 billion.

A second project is being tendered by CFE Transmisión, a subsidiary of CFE and the entity responsible for power transmission service in Mexico. This project is intended to transport the power generated by a significant number of renewable power plants located in the Istmo de Tehuantepec region, southeast Mexico, to Mexico's central, industrialised region. It includes the design, construction, equipment, installation, operation and maintenance of a ± 500 kV DC-transmission line of 1,200 circuit kilometres from Ixtepec, Oaxaca, to Yautepec, Morelos, with a transmission capacity of 3,000 MW. The estimated investment for this project, including both AC and DC portions, is approximately \$1.6 billion.

A third sector to watch in 2017-18 is transportation. In particular, Colombia's fourth generation (4G) road infrastructure program – made up of 47 projects covering 8,000 km of road and 3,500 km of

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highway – has been making waves. The Odebrecht corruption scandal (discussed below) has hampered progress under the 4G program, but a greater role for the national development bank and more clarity from the government in the form of new procurement legislation resulted in an acceleration of financing for these projects in 2018.

What tend to be the greatest impediments to Latin American projects?

In recent years, a major impediment to Latin American infrastructure projects – particularly those to be developed by public-private partnership (PPP) – has been corruption. In late 2016, the Brazilian construction giant Odebrecht admitted to paying nearly \$800 million in bribes in 12 countries over 15 years. Across the region – and particularly in Brazil, Peru and Colombia – construction on billions of dollars’ worth of infrastructure projects has been put on hold as Odebrecht unwinds its positions. Notably, construction of the \$7 billion Gasoducto del Sur project in Peru, in which Odebrecht was an investor, stalled after the lenders refused to disburse further funds following the revelations of corruption.

Legal uncertainty in some countries has been an impediment to the investment in and development of infrastructure projects. As an example, in Peru, a concession agreement for the construction of a new airport in Cusco was unilaterally cancelled last year, resulting in arbitration with the concessionaire. In Mexico, the recent election of a left-leaning populist, Andrés Manuel López Obrador (AMLO), has generated some concern over the prospect of the energy reform enacted by his predecessor, as well as some other major infrastructure projects, such as the new Mexico City airport, which is under construction. But given that the energy reform was enacted by constitutional amendment, it will be very difficult to unwind. However, AMLO has indicated that his administration will conduct a review of all major concessions and project awards granted by the Peña Nieto administration, effectively halting them until the review is completed.

Economic instability in some Latin American countries has also been a risk for developers. Last year saw the cancellation in Brazil of 557 MW worth of wind and solar PPAs for developers facing slowing demand and reduced credit availability. Still, the market is now generally bullish for renewables, even in Brazil, where a recent auction awarded new renewables PPAs for the first time in several years.

Indeed, recent renewables auctions in Latin America have been so competitive as to leave some observers wondering about whether solar and wind projects in the pipeline can be economic. The latest renewable energy auctions in Mexico and Chile saw average prices of \$20.57 per MWh and \$32.5 per MWh, respectively.

Are there issues that developers, sponsors and contractors underestimate or neglect?

Developers and sponsors often underestimate the length of time it can take to obtain financing for a project and the complexity involved in such financings. This is particularly true with respect to projects being developed under newer legal frameworks, like the Mexican and Argentine renewables regimes. In these situations, the market has not yet settled on a framework for the allocation of risk between the relevant parties and lenders and their counsel need time to perform the required due diligence on new regulatory regimes, PPAs and inter-connection agreements.

The difficulty of the community consultation process has also been underestimated in some cases. Developers, sponsors and contractors must be sure to undertake a proper environmental and social review, particularly in areas near indigenous populations. In Mexico, a number of wind projects have faced delay and potential cancellation resulting from challenges from indigenous populations in Oaxaca and Yucatan. Chile has also had its share of projects face difficulties due to environmental issues, like the Octopus LNG terminal, which as a result of the loss of its environmental license is unlikely to be built and financed.

What roles do environmental and civil society issues play in pursuing an expedient timetable for an infrastructure project? What do sponsors need to do to win approval in these areas?

The answer to this question depends greatly on the type of project, the location of the project and the source of the project’s financing. Projects in the extractive industries will generally require longer and more rigorous consultation periods than renewable energy projects. Sponsors need to be aware of not only national and local laws and regulations but also the social and environmental standards they will be held to by the institutions that provide them with financing. The IFC Performance Standards are the most widely used by development finance institutions, and many commercial banks that invest in infrastructure projects in Latin America adhere to the Equator Principles, which are based on the same standards.

Environmental and civil society issues for projects located near indigenous communities need to be reviewed particularly carefully. A lack of consultation and agreement with the local communities can result in delay or cancellation of a project. Unfortunately, in some jurisdictions, risk may remain even for developers who undertake careful consultation. In Mexico, Peru, Ecuador and Chile, several projects faced significant adversities resulting from social issues. In Mexico, this led the Mexican government to include in the 2014 energy sector statutory reforms requirements and guidelines for social impact studies for energy projects to mitigate the risk and uncertainty to private investors developing energy projects in the country. Now, fair compensation for the acquisition of real estate rights is a statutory requirement and a social impact study that includes an action and redress plan for social communities in the area where a project is being developed must be presented to the Ministry of Energy for approval prior to regulatory approval of a generation permit, in the case of electricity projects, or execution of contracts for activities in the hydrocarbons industry.

Sponsors and developers must now integrate into their development and financial plans mechanisms that provide a benefit to local communities, including through direct employment, community benefits (such as the provision of health services or education) or infrastructure (in the form of roads, clinics and water treatment plants, to name a few).



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Sponsors should be aware that even for minimally invasive projects in low-risk areas, legal regimes and the performance standards imposed by their investors and lenders will require consultation beginning in the early stages of development and monitoring throughout the life of the project.

How do much more significant, when it comes to getting your project moving forward, are climate change issues now than they were a few years ago?

Governments across the region are taking climate change seriously, setting ambitious clean energy targets and implementing legal and regulatory initiatives designed to bolster the market for renewables. Similarly, development finance institutions active in the region are committed to financing renewable energy projects. The IFC, for example, has set a goal of scaling climate-related investments to reach 28% of its long-term own account financing by 2020, which would represent a 50% increase in the five years since that target was established.

What influence is institutional investor appetite having on the way projects are being structured? Is it opening up more opportunities to sponsors?

Institutional investors have been active in Latin American infrastructure investment for years. Canadian pension plans have been in the vanguard and will continue to play an important role, particularly in energy and transportation projects. They are expected to continue to make big-ticket, long-term equity investments in the region through investment funds. With Odebrecht's exit from many large-scale infrastructure projects in the region, the role for institutional investors may be increasing. In addition, as commercial banks have lately found it challenging to provide capital for the 15- or 20-year terms necessary to finance major infrastructure projects, there is speculation that pension plans may begin to step into this space as well, opening up additional opportunities for sponsors. In Chile, for example, new regulations now permit pension funds to provide limited debt in bank-financed transactions, so it is widely expected to see more direct lending by these institutions over the next few years as they become comfortable with project finance transactions.

On the other hand, as is well known, institutional investors continue to be averse to both construction and merchant risk. In structuring transactions, institutional investors investing directly in projects



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through capital markets mechanisms continue to require full wrap protection by the sponsors. For credit agencies to consider a project investment grade, financial structuring tends to be more conservative, with higher debt service coverage ratios than normal bank financing would require to cover, for example, merchant risk.

As institutional investors generally require higher returns than privately-backed sponsors, this can lead to lengthy and difficult discussions with sponsors and contractors alike. In certain very competitive sectors, like power, where returns are decreasing, several institutional investors have decided altogether not to invest and focus their investments in more specialised and less crowded sectors, like water treatment and port projects.

Will China soon come to dominate project development across the region, and what changes might this bring?

Chinese investments are playing a greater role, but they are not likely to dominate project development across the region any time soon. Recent years have seen a shift from state-to-state lending to a greater focus on private investments. We are seeing a greater number of Chinese state-owned entities purchasing operating assets in the region, rather than developing greenfield projects. Chinese entities have had difficulties adjusting to Latin American cultures and have had an easier path investing jointly with local players or in operating assets. For example, we have seen acquisitions in the mining and power sectors in Chile, Ecuador and Peru, while in Argentina, over 50% of renewable projects that won contracts in the RenovAr renewable energy rounds, are backed by Chinese equipment vendors and financiers. In terms of state-sponsored financing, China has entered into significant partnerships for the provision of project loans side-by-side with the IFC and the Inter-American Investment Corporation. Since these investments are co-financings, they have not done much to re-shape priorities or structure for projects in the region. However, Chinese banks are opening branches in various countries in Latin America in the hope of becoming players in the financing of infrastructure and energy projects, developed by both Chinese and international or local sponsors and developers.

Although the only Latin American country formally included in China's Belt and Road Initiative (BRI) is Panama, China is beginning to eye investments in infrastructure throughout Latin America. China has emphasised its interest in building a transportation network in the region that connects land and oceans, and is seeking to sign BRI agreements with additional countries. As a result, developers may begin to see increased availability of capital for transport infrastructure in the region.