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Tapping Chinese Belt and Road capital for power projects

Ten things to know

Tapping Chinese Belt and Road capital for power projects

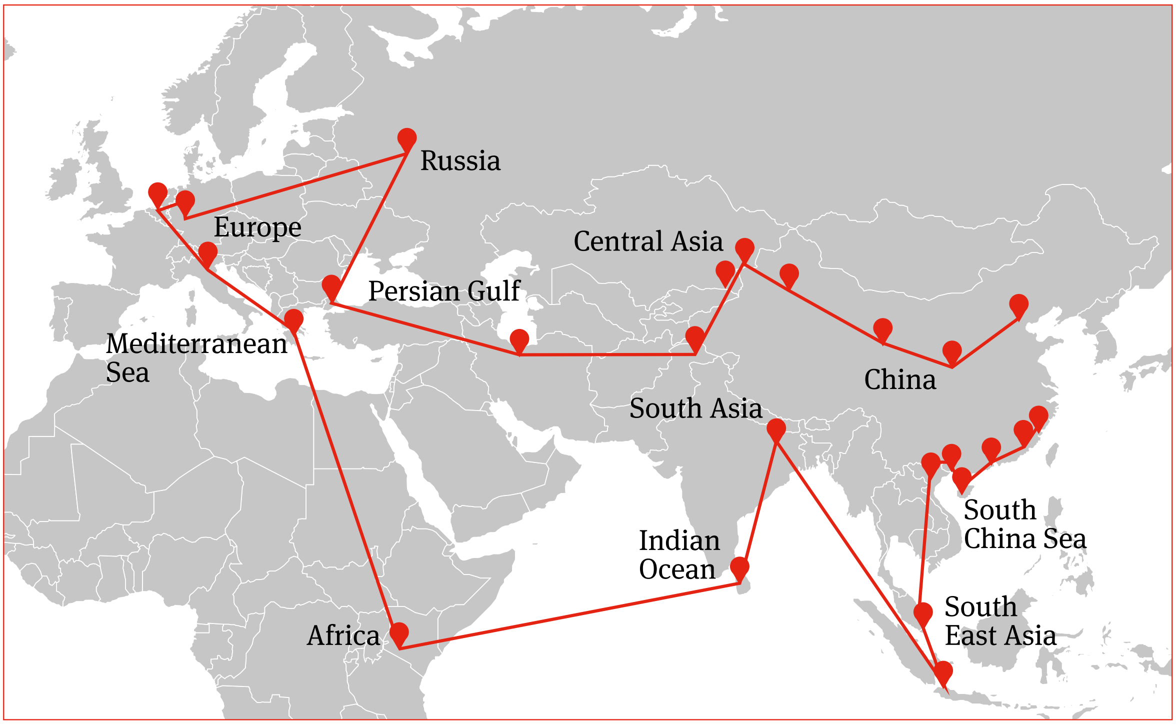
China's Belt & Road Initiative (B&R) could see up to USD1.5 trillion invested in the 60 countries that comprise the B&R. This will make China the largest funder of power in the region.

The sweet spot for Chinese banks, contractors and equipment suppliers, is difficult jurisdictions like those that make up the B&R – in these countries Chinese pricing of kit and debt is competitive, funds are deployed relatively quickly and importantly, Chinese capital comes with a partial fix for host country political risk. For any investor in emerging power markets, Chinese capital cannot be ignored. In this outline we look at how to tap it.

01 | Is your target country Belt & Road?

Chinese diplomats have promoted an all-encompassing definition of B&R that extends to Australia, South America and the UK. The diplomat's version avoids offence, but it does not accurately describe where Chinese capital is currently going. It is currently focused on a narrow band of Asian, Eurasian and African countries.

The ideal host country for Chinese capital is along the core B&R, one which maintains a good relationship with China and is typically not covered by commercial banks. The country would ideally have relaxed labour controls, allowing for the deployment of Chinese labour and is preferably one that Sinosure, Chinas export credit insurers not over exposed to.



02 | Is your target country open to Chinese investment?

Some countries continue to be sensitive to investment by Chinese companies, particularly state owned enterprises. You need to understand the additional scrutiny from foreign investment approval authorities that partnering with a Chinese company may bring - particularly as any B&R partner will generally be state-owned.

03 | Is there a tight bid timeframe?

The more international Chinese companies and private Chinese companies can readily meet tight bid timelines. More locally owned Chinese state owned enterprises with less international experience find this more difficult. In addition to the outbound approvals regime, Chinese bank support can be a source of delays. The term sheets and commitment letters can be pulled together quickly but credit approval can take time.

04 | Can you accept a minority shareholding?

The typical opportunity open to a foreign investor looking to tap Chinese B&R capital will be a sponsor role. A foreign investor will not be able to take key EPC, sub-contractor or supplier roles because the project would then fail to meet requirements for China content in the investment.

Generally, the Big 5 Chinese power companies (see table) will need to be the majority shareholder, but if your partner is a Chinese EPC contractor or turbine/panel supplier, you may be able to negotiate a majority shareholding.

China's big five state-owned power companies
China Guodian Corporation
China Huadian Corporation
China Huaneng Group
China Power Investment Corp (CPI)
Datang Intl Power Generation Co., Ltd.

05 | Identify your Chinese EPC Contractor - your key route to Chinese banks

The contractor, not the borrower/sponsor, is the Chinese bank's customer. That means you need the contractor to secure finance on attractive terms and to overcome negotiation obstacles. You should establish early on the substance to Chinese finance support, as contractors can make rash promises around finance when securing an EPC mandate. Investors should be cautious around promises of concessionary terms and you should check the bank's position on recourse to sponsors and change of control. Key points should be negotiated up front and ideally, a finance term sheet stapled to agreements with the contractor.

06 | Maintain competitive tension to manage execution risk

Projection execution risk tends to be higher when foreign companies partner with Chinese companies. Negotiations drag on, agreed positions are re-opened, requirements for recourse to the sponsor are raised each time a new obstacle is encountered and outbound and credit approvals fail to materialise. A key to managing execution risk is to maintain competitive tension from a non-Chinese contractor for as long as possible.

07 | Understanding Chinese outbound approvals

The Chinese outbound approvals and Chinese bank credit approval processes are not well understood. Carefully managed, the risks these approvals present are minimal. The key is to understand which regulators need to approve the transaction (see the table on The Key Regulators below), when the approvals will be obtained and whether the transaction documents need to be conditional upon outbound approval. It is important to be aware of problems as early as possible.

The Key Regulators

SASAC	NDRC	MOFCOM	SAFE
State-owned Assets Supervision and Administration Commission	National Development and Reform Commission	Ministry of Commerce	State Administration for Foreign Exchange
Responsible for regulating state-owned assets	Has broad planning control of the Chinese economy. This includes a key role in regulating outbound Chinese investment.	Broad responsibility for developing policy on trade, investment, competition and other areas, works with the NDRC to regulate outbound investment.	Responsible for regulation of foreign exchange.

08 | Keep documents and structures simple

The importance of keeping documents and structures simple and following established precedents used by Chinese investors on similar projects cannot be over-emphasised. Your partner will generally need board, shareholder, credit and various governmental approvals or registrations all of them need to understand the structure of the transaction.

The credit departments of the Chinese banks in particular are the busiest in the world. A simple structure that follows established precedents will be approved more quickly than a new one.

09 | Is there sovereign support for the Power Purchase Agreement (PPA)?

Chinese banks require Sinosure cover in order to fund a project. Sinosure generally prefers to sit behind a sovereign guarantee of the PPA offtaker obligations. Chinese power projects in difficult jurisdictions have generally had sovereign support for the offtake.

Recent Chinese tenders in Pakistan and Indonesia are testing this requirement, but in any event, strong sovereign support for the offtake will mean easier approvals.

10 | In the event of dispute, you can enforce a Chinese parent company guarantee

Foreign investors tend to over-emphasise enforcement risks when dealing with a Chinese EPC contractor. Your contractor's parent company guarantee will invariably be with a mainland Chinese state owned enterprise, probably based in Beijing. That means in the event of a dispute, your Singapore, London or Hong Kong arbitration award may ultimately need to be enforced in courts in Beijing. China has introduced procedures to ensure that such awards are readily enforced in China, and in practice, this should usually be the case. However, occasionally sponsors have encountered issues calling bank guarantees from Chinese banks. While rare, there have been cases of Chinese courts claiming jurisdiction to restrain a call on the bank guarantee, even where the jurisdiction of Chinese courts had been excluded. This risk should not be overstated, but sponsors should still consider asking for bank guarantees issued by a non-Chinese bank.

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