

Project finance in Turkey's energy sector: a Turkish delight for financiers

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In 2009 the number of project finance transactions in Turkey decreased considerably. The lack of willing banks and finance institutions to finance projects in 2009 due to economic circumstances led to the modification of the understanding of project finance. Accordingly, project finance documentation changed face. This article seeks to point out the modifications undertaken in various documents, such as security documents, guarantees, etc, and the conformity of such modifications with Turkish law.

A. Introduction

Despite the financial crisis and its effect on the world economy, the Turkish economy has, due to its experience in 2001, sustained itself. No Turkish bank has collapsed and the Banking Regulation and Supervision Agency has been able to maintain the capital adequacy ratio of banks. However, the impact of the financial crisis nevertheless affected investments in Turkey to a large extent since Turkish and non-Turkish banks felt that it was risky to finance mid-sized to large investments. This was particularly notable in the project finance sector in Turkey. Even the few projects financed during the crisis were realised through syndications, where the forerunners of such syndications were not commercial banks but international finance institutions (IFIs). Those projects that did not attract any IFI were doomed and those projects that did attract IFIs took a long time to close. This was mainly due to the fact that none of the financiers involved wanted to assume the slightest risk. Accordingly, the financiers' demands increased and the project finance documentation changed face. Non-recourse loans became limited- or full-recourse loans, and accordingly the choice of project finance loans rather than corporate loans meant unnecessary expense to the sponsors. Financiers focused on (i) how to create a tighter security package than before; (ii) how to find recourse to the sponsor and/or the topco entity in the sponsor's group; and (iii) how to obtain comfort from governmental organisations to overcome any question marks regarding the Turkish legal environment.

1. Security – to be or not to be?

Foreign financiers used to the rights granted to beneficiaries under English-law-governed security are worried about the complexity of enforcing Turkish-law-governed security. Foreclosure proceedings follow a rigid procedure under Turkish law, whereby the properties/assets secured are generally sold by way of public auction and the sale proceeds are then distributed to the beneficiaries of such security.

Accordingly, due to this compulsory process the completion of foreclosure proceedings can be time consuming.

Certain other rights which are perhaps less problematic in common law jurisdictions (most notably under English law) but are quite problematic under Turkish law are also a deterrent to foreign financiers when it comes to security aspects under Turkish law. For instance, pursuant to Article 5 of the Electricity Licence Regulation, dated 1 March 2009, banks or finance institutions which provide limited or non-recourse project financing, in accordance with the provisions of their loan agreements, have the right to request from the Energy Market Regulatory Authority that a replacement entity be granted a new licence which will then assume all the responsibilities of the original licensee. This provision is a response to foreign financiers' demand to incorporate "step-in rights" under Turkish law. Accordingly, under the Electricity Licence Regulation, quasi "step-in rights" are somehow now regulated but how the procedure will work in practice is ambiguous and has yet to be put to the test.

It is therefore perhaps not too surprising that foreign financiers opt for additional comfort in project finance deals in Turkey. However, it is surprising that foreign financiers structure certain deals in project finance terms despite prior knowledge that they would be lending to an entity situated in a civil law jurisdiction – it is not extraordinary in civil law jurisdictions for foreclosure proceedings to follow a rigid procedure and for "step-in rights" to be a problematic concept to enforce.

(a) Security over immovables and movables situated in Turkey

Pursuant to Article 2 of the Turkish Private International Procedure Law (PIPL), parties are permitted to choose the law that shall govern the relevant agreement provided that certain criteria are met. However, Turkey has exclusive jurisdiction in certain areas which are specified in the PIPL. Accordingly, these areas are exempt from the basic principle specified in Article 2 of the PIPL. Jurisdiction over movables

and immovables situated in Turkey is one of these exemptions, and pursuant to Article 21 of the PIPL is subject to Turkey's exclusive jurisdiction (*lex rei sitae* principle). Therefore, the security documents in relation to movables and immovables have to be governed by Turkish law if the respective movable or immovable of the borrower is located in Turkey. Given that Turkish law expressly states the legal rules in relation to assets that are located in Turkey, it is all the more remarkable that financiers started to ask for an English-law-governed fixed and floating debenture over the same assets that are located in Turkey, in addition to a Turkish-law-governed so-called commercial enterprise pledge. As for the reasoning behind such a demand, the belt-and-braces approach is a favourable one, in the remote likelihood that these assets (if moveable) somehow find their way to other soil during transit to or from Turkey. From a legal perspective it is also interesting to mention that typical English law security provisions (such as the ones relating to mortgagee in possession rights) will not be applicable and hence not enforceable in Turkey. Any assets situated in Turkey will be subject to foreclosure proceedings in accordance with Turkish law. Therefore, the demand for additional English law security over the same assets is redundant since its intention will not be achievable, namely the application of standard English law security provisions and double protection against financial risks.

(b) Release periods

Another issue worth noting and one of great importance to the borrower is the security release period. It is obvious that financiers do not want to assume the slightest risk. However, the incorporation of specific security release periods (eg one year following the full satisfaction of all obligations by the borrower) does not give any more protection to financiers in the event of the borrower's insolvency. This scenario is already covered by so-called "boilerplate" provisions under standard security documentation as well as by statute. Therefore, from a borrower's perspective, it is questionable why a borrower should accept such specific security release periods, even if such demand is made by financiers in hard economic times.

The financiers' demand of a one-year release period can be attributed to Article 279 of the Turkish Code of Execution and Bankruptcy (CEB). Article 279 of the CEB lists different case groups where a payment or disposal can be voidable and annulled within one year following the date on which the payment or the disposal was made. The focus is on Article 279/3 of the CEB which states that "payments of undue debts are void if the debtor who does not pay its debts made the payment because of sequestration or since he has no further assets, each transaction done one year prior to foreclosure proceedings".

The following criteria have to be satisfied in order to come within the scope of Article 279/3 of the CEB: (i) the payment of undue debts; (ii) the debtor's insolvency at the date of payment (insolvency in this case is defined as over-indebtedness¹); and (iii) the payment was made by the debtor one year following the debtor's insolvency, sequestration and confiscation/foreclosure proceedings.

In this regard Article 280 of the CEB is also worth mentioning. Article 280 CEB states that "all disposals which have been made with bad faith in order to harm the creditors by the debtor whose assets are not sufficient to repay the debt, can be annulled if the counterparty knows the debtor's intention or should have known it due to obvious indications". The intention of Article 280 of the CEB is to annul the debtor's disposals which have been made with the purpose of inflicting damage on the creditor. Fraudulent actions are a typical case group, such as title transfer of the relevant property to a related third party in order to hide assets from creditors (eg transfer of an immovable to a relative so that the relevant immovable is no longer subject to foreclosure proceedings). The following criteria have to be met in order to be within the scope of Article 280 of the CEB: (i) the disposal was made with the debtor's intention to harm the creditor;² (ii) the third party to which the disposal was made was aware or should have been aware of the debtor's bad faith; and (iii) five years following such disposal (at the latest) the debtor has to become subject to foreclosure proceedings due to its debts owed to the creditor.

However, the legislator's intention with these provisions is to protect the creditor against disposals or payments which the debtor made to other creditors although it was aware of its insolvency. As regards Article 279 of the CEB, this issue is only relevant if the borrower makes "undue payments". It is therefore questionable which payments have to be considered as "undue payments". If, for example, pursuant to a loan agreement, the borrower is entitled to prepay the loan, this should not be classified as "undue payment". If the borrower issues a prepayment notice to the lenders, the debt, at that point in time, becomes due and payable. One other possible argument is that the borrower makes a prepayment to avoid interest being applied to the prepaid amount. This is a corporate benefit to the borrower. Accordingly, such action should not be viewed as an "undue payment" since it makes commercial sense. In our view, therefore, the application of these provisions has been misused by financiers to make the security even tighter.

The incorporation of fixed release periods of one year or more makes it difficult for borrowers to go for refinancing as the security will remain in force for one year or more although the debt obligations of the borrower to the financiers have been fully satisfied.

(c) Absolute assignment

The financiers' demand for an absolute assignment within the scope of the assignment of receivables in the security package is also noteworthy. Instead of having the right to receive certain receivables upon the occurrence of an event of default by the borrower, the financiers ask to appoint the borrower as an attorney-in-fact by way of a power of attorney in order to receive these receivables to which it already has a right (provided that no event of default has occurred). However, despite this power of attorney being "irrevocable" under English law, it can (due to mandatory rules under Turkish law) be revoked by the financiers at any time. Pursuant to Article 297 of the Turkish Code of Obl-

gations the appointment of an attorney-in-fact is revocable at any time and not subject to any conditions. There is of course the possibility of entering into a separate document whereby the appointers agree not to revoke the appointment of the appointee and if they do so in contravention of this agreement, they are liable to pay damages to the appointee. However, the enforceability of such agreement is questionable under Turkish law since it tries to circumvent mandatory rules prescribed under Turkish law.

2. Corporate guarantees disguised as completion and price guarantees

Turkey's topography lends itself to generating electricity from renewable energy resources (eg wind and hydro) and guarantees play an essential role in such renewable energy projects. Pursuant to the current law concerning the Use of Renewable Energy Sources for Electricity Generation (Law No 5346), legal entities may benefit from a purchase guarantee. Accordingly, entities which generate energy from renewable energy sources can be granted a "Renewable Energy Source (RES) Certificate" by the Electricity Market Regulatory Authority (EMRA). Entities which hold such certificates are entitled to benefit from a purchase guarantee pursuant to Article 6 of Law No 5436. The purchase guarantee guarantees off-take of the electrical energy produced from RES at a price that shall not be lower than 5 euro cent/kWh and not higher than 5.5 euro cent/kWh.

However, since the purchase price guarantee in the current Turkish legal framework is subject to the Turkish average wholesale electricity price in the previous year determined by EMRA, this results in a standard price for all renewable energy resources instead of separate prices for each renewable energy source. Such distinction is of great importance as construction and operation costs are not equal for all RESs.

Hence, financiers demand additional guarantees even in RES projects for which some form of state guarantee already exists. However, during the financial crisis the scope of such guarantees has become much wider.

(a) Price guarantee

The purpose of a corporate price guarantee is to set a fixed amount of electricity to be generated during a fixed time period to be sold for a fixed price. However, from the guarantor's perspective such a guarantee needs to fall away in certain circumstances – ie the occurrence of a total loss or material destruction which prevents the borrower from operating the project and thus generating/selling electricity, etc, prepayment (either voluntary prepayment or upon receipt of insurance proceeds), and acceleration of the loan and hence enforcement of security.

However, despite the market being used to such termination events, financiers are increasingly demanding that the price guarantee should remain in full force and effect: (i) for a fixed period following such termination events; (ii) in case of enforcement of security, until the proceeds following foreclosure proceedings are paid to the financiers; (iii) until the project company/project is sold by the financiers to a

third party (including a competitor); and (iv) in case of confiscation and nationalisation.

In addition, instead of releasing the guarantor from its payment obligations under the guarantee in case of a *force majeure* event (which is beyond the control of the project company and the guarantor), financiers demand that the guarantee remains in place for a period of time following such a *force majeure* event. This is perhaps the market standard in certain markets. However, if one considers that such a period of time is not only a few months but can extend to two years, this becomes less sustainable in financial terms for a guarantor (sponsor).

(b) Completion guarantee

Another form of known guarantee is the completion guarantee. However, during the financial crisis this guarantee has been used more as a risk-wrapping instrument rather than to secure completion of the project. Financiers demand that the topco entity in the sponsor's group issues this type of guarantee to guarantee the obligations (payment and non-payment obligations) of the project company, the operator, the guarantor under the price guarantee, the sponsor and the contractors.

3. Governmental authorities

A further trend which has developed during the economic crisis is that financiers have started to demand undertakings from Turkish governmental authorities. The purpose of this requirement is again to safeguard against the slightest risk. The financiers' main concern is to ensure that the relevant state entity will not interfere in the project (by revoking or terminating the approvals, licences, permits, etc) so that recovery of their investments is secure. As a matter of course, Turkish governmental authorities are not willing to give such undertakings as it is not within their competence to issue them. In general, governmental authorities play a crucial role in terms of approvals, authorisations, permits, etc (the "Permit"). The scope of such Permit has to be in line with applicable law. However, in addition to such Permit, no state entity is legally entitled to sign any other document, especially undertakings, which try to extend the legal scope of the Permit. Any extension of grace periods or conditions for termination or revocation of a Permit cannot be granted by way of an undertaking but must be prescribed in the Permit or regulated by law. It is therefore obvious that no governmental authority can comply with the financiers' demands which do not comply with Turkish law. As is the case in all constitutional states, Turkish state entities, *inter alia*, are bound to the laws, regulations, etc, and do not have discretion to grant something in contravention of the legal framework.

B. Outlook

The financial crisis has forced sponsors that have already started a project on the presumption that a syndicate of banks would be interested in co-financing it to accept most

demands by banks in order to bring the project to a successful closure. This means that the banks did not only focus on project assets or on project cashflow to secure and pay back their loans but also on the assets and creditworthiness of the sponsor itself. Although project financing was usually not non-recourse in Turkey, the more generally accepted limited recourse project financing has shifted to a rather full recourse project financing, albeit that such full recourse is disguised in documentation which was previously used for limited recourse financing. It remains to be seen whether with the stabilisation of the economic situation, sponsors will again be in a position to focus the lenders'

attention on the project assets and project cashflow, rather than their own assets and creditworthiness. Maybe then, project financing will again serve its purpose, namely to finance projects and justify the costs involved in packaging an investment in project finance terms. ■

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¹ Baki Kuru "İcra ve İflas Hukuku" s 1203, §121 C)I.

² Baki Kuru, s 1206, § 121 D.