PIONEERING FINANCING SUPPORTS SIC-SING INTERCONNECTION

THE CHILEAN ENERGY SECTOR WILL UNDERGO A REVOLUTIONARY CHANGE IN 2017, AS THE TWO MAJOR GRIDS, THE SISTEMA INTERCONECTADO DEL NORTE GRANDE IN THE NORTH, AND THE SISTEMA INTERCONECTADO CENTRAL, WHICH COVERS THE CENTRE AND SOUTH OF THE COUNTRY, WILL BECOME INTERCONNECTED. BY **CYNTHIA URDA KASSIS**, PARTNER, **ALEXANDRO PADRÉS**, PARTNER; **ROBERT O'LEARY**, ASSOCIATE, AND **IGNACIO VALENZUELA NIETO**, INTERNATIONAL ASSOCIATE, **SHEARMAN & STERLING LLP.**

This long sought-after event will become a reality once Transmisora Eléctrica del Norte SA (TEN) completes the construction of its double-circuit, 500kV, 600km-long transmission line and associated substations extending from Mejillones to Copiapó. This article outlines how the many pieces of this ground-breaking project came together.

The SIC-SING interconnection has been a long-standing goal of multiple administrations of the Chilean government and one of the most significant infrastructure projects in Chile in the last several decades. It will permit the two major grids, the Sistema Interconectado del Norte Grande (SING) – which accounts for approximately 22.8% of Chile's power generation[1] and is situated in a region with world-class conditions for an increasing generation of solar power and significant production of thermoelectric power intended primarily for mines – and the Sistema Interconectado Central (SIC), to constitute one unified grid.

The SIC accounts for approximately 76.5% of the Chilean power generation[2] and supplies energy to the vast majority of Chilean households and businesses, mainly from hydro power, diesel, thermoelectric power and natural gas.

Once the SIC-SING interconnection is completed, it will allow the so-called Chilean electricity highway to become operative, which is expected to happen by late 2017. The unified grid will have an installed capacity of 24,000MW and supply approximately 99% of the Chilean population[3] extending from Arica in the north to the Isla Grande of Chiloé in the south of the country – due to Chile's unique geographic conditions 3,100km away from each other[4].

The long-awaited interconnection is expected to lead to increased efficiency, enhanced competitiveness of Chile's blooming renewable energy sector, and reduced energy prices, while also bringing significant stabilisation and security of supply and, overall, facilitating economic development of the country.

TEN is a joint-venture equally owned by subsidiaries of Engie and the Red Eléctrica group. Engie, the French-headquartered energy giant, is a long time investor in a number of major projects in Chile and Latin America, including energy production, renewable and non-renewable, energy distribution, and LNG regasification and trading.

Engie's participation in TEN is through its subsidiary Engie Energía Chile SA, a company publicly traded on the Santiago Stock Exchange, which is the main electricity generator in the SING with 38% of the system's installed capacity[5].

Spain-based Red Eléctrica group is the sole transmission system operator in Spain, with more than 42,000km of transmission lines under operation. It began its Latin American experience in the late 1990s and has focused its activities in the region on the construction and operation of transmission lines in Peru. Since 2015, with the incorporation of Chilean subsidiary Red Eléctrica Chile SpA, through which it holds the group's stake in TEN, Red Eléctrica has sought to consolidate its presence in the region by pursuing further investment opportunities in Chile.

The Chilean Government kicked-off the interconnection initiative in early 2015, when the Ministry of Energy established that the TEN project would be part of the Trunk Transmission System and a key part of the much expected grid unification. The project's north end connection to the SING would be through the Changos–Kapatur transmission project (currently being developed by Chile-based Transelec) and the south end's connection to the SIC would be through the Polpaico–Cardones transmission project currently being developed by Colombia-based ISA.

The project and the adjacent transmission lines are all required to be operational by early 2018. TEN's major pre-financing milestones were: its environmental approval, obtained in June 2012; the execution of the EPC contracts in late 2014 and early 2015, with separate contractors engaged to work on the construction of the transmission lines and the substations; the issuance of the decree establishing the project as part of the SIC-SING interconnection and setting forth its general conditions in April 2015; the confirmation of the

project as a trunk transmission project by the National Energy Commission and the launching of the financing process by mid-2015; the engagement by Engie of Red Eléctrica as strategic partner by January 2016; and the enactment of the new Chilean transmission law contemplating the unified grid in July 2016.

Financing of the project

Until recent years, Chilean transmission projects were traditionally financed by structures allowing for corporate recourse against the sponsors. It was approximately five years ago when transmission projects in Chile began evolving to structures that came closer to a true limited recourse financing.

In this context, TEN completes the transition, as it is developing its major transmission project with a US$850m-plus true limited recourse financing. In addition to this significant achievement, the project is also pioneering in featuring an innovative debt structure including multi-tranche, dual-currency with US dollar and Chilean peso denominated debt, both fixed and floating interest rates and a combination of multi-draw term loans, a value added tax facility, and a private placement.

The lender group was comprised five international banks: Instituto de Crédito Oficial, KfW IPEX-Bank, Mizuho Bank, Sumitomo Mitsui Banking Corporation, and the Bank of Tokyo-Mitsubishi UFJ, which provided an international US dollar senior loan facility; four local banks: Banco de Chile, Banco de Crédito e Inversiones, Banco del Estado de Chile, and Banco Santander-Chile, which provided a Chilean peso senior loan facility and three of which provided a value added tax facility; and a US-based insurance company, (Prudential Insurance Company of America), which purchased the US dollar fixed-rate notes issued under the private placement.

The total investment required for the project is approximately US$1bn, including financing costs and value added tax. The financing provides for a total loan amount of approximately US$804m[6] and a bond amount of US$50m. The project reached financial closing on December 16 2016, when the initial drawdown under the loan facilities and the value added tax facility took place, and all the notes pursuant to the private placement were issued.

The financing of the project consists of four tranches, featuring dual-currency and floating and fixed rates, with tenors ranging from 3.5 years to 26 years.

The tranches were structured as follows:

(i) a US dollar-denominated floating-rate term loan for a total amount of US$460.4m, payable semi-annually after a specified grace period, with a final maturity in 2034 documented in an International Senior Loan Facility Agreement under New York law;

(ii) a peso-denominated floating-rate term loan for a total amount of the peso equivalent of US$232.9m, payable semi-annually after a specified grace period, with a final maturity in 2034 documented in a Local Senior Loan Facility Agreement under New York law;

(iii) a US dollar-denominated private placement of fixed-rate notes for a total amount of US$50m, payable semi-annually after a specified grace period, with a final maturity in 2042 documented in a Fixed Rate Note Purchase Agreement under New York law; and

(iv) a peso-denominated value added tax facility for the financing of the value added tax to be borne by TEN in connection with the assets and services needed for the construction and operation of the project, for a total amount of the pesos equivalent of US$110.7m with a one-time bullet payment in 2020 documented in a value added tax facility agreement under Chilean law.

The financial debt was divided between US dollars and pesos to match the expected currency breakdown of cashflows and provide a natural hedge to the project. Certain foreign exchange hedging agreements in connection with TEN's capex currency commitments under the existing EPC contracts and other costs were entered into to match the US dollar and peso proceeds of the financing.

Other relevant agreements

In addition to the agreements mentioned above, other key financing documents include (i) a Common Terms Agreement, including representations and warranties, covenants, events of default, and other provisions that are customary for this type of transaction and some additional unique features some of which are described below, (ii) Equity Contribution and Share Retention Agreements, pursuant to which the sponsors agreed to provide base and contingent funding to TEN in the form of capital contributions or affiliate subordinated loans and agreed to certain share retention obligations, (iii) a Common Agency Agreement, which sets forth the appointment of certain financing party representatives and their respective rights and obligations in respect of the financing documents, and (iv) various security documents under New York, English, and Chilean law to provide security to the lenders for the repayment of the amounts owed to them. Other than certain security documents and the value added tax facility agreement, all of the financing agreements are governed by New York law.

Since most project collateral including notably most accounts is located in Chile, significant coordination was required between New York and Chilean counsel to come up with a security documentation proposal satisfactory to all the various parties involved.

The collateral package includes: an Intercreditor Agreement and a Master Collateral and Accounts Agreement – under which a depositary agent was appointed and the transfers and related mechanics between several offshore and onshore collateral accounts were set out – governed by New York law; subordination agreements under New York and Chilean law; direct agreements under English and Chilean law with respect to the existing EPC

contracts and other relevant project agreements; and several security documents under Chilean law providing for the creation of first and second-priority liens over the project's assets in favour of the lenders, with the lenders under the value added tax facility benefiting from a first-priority lien over the value added tax recovery account and a second-priority lien over the remainder of the project's assets.

Additional special features

In addition to the general challenges posed by the implementation of the financing structure, additional innovative features of the transaction and issues dealt with during the structuring process include the following:

- *Combination of term loans, involving international and local banks, with a private placement* – The project featured an innovative combination of financing sourced from international banks, Chilean banks, and a private placement. This unique multi-tranche structure required addressing intercreditor issues on a diverse range of underlying debt conditions, which was novel for various of the parties involved.
- *Changing regulatory background* – During the negotiation of the financing documents, Chilean lawmakers were discussing the final form of the new transmission law, which would determine how energy transmission in the country would be planned and compensated. These circumstances demanded considerable flexibility from the parties and creativity from their advisers to adapt to new scenarios, until the law was finally enacted in July 2016.
- *Overlap of mining and power sector regulatory frameworks* – The financing documents account for the relationship under Chilean law between electricity concessions and mining concessions. To address the peculiarities of that interaction, the financing documents contemplate a variety of mechanisms, including provisions regarding the allocation of borrowings, contingent equity requirements, and specific reserve accounts.
- *Conditions precedent for the incurrence of required modifications debt* – The financing documents had to address the ability of the Chilean government, through the National Energy Commission, to decide if and when any expansion, extension, upgrade or other modification to the project was needed. The government would also control the related construction services tender process for the relevant works, although TEN would be required to fund the modifications. To navigate these potential scenarios, the financing documents set out certain conditions precedent that must be satisfied for TEN to incur debt to fund any such required modifications.
- *Project-related hedging requirements* – Due to the nature of the project and the revenue structure associated with the project's operation, the financing documents set forth in detail the nature and scope of the hedging agreements to be entered into and maintained by TEN throughout the life of the debt documents. TEN not only implemented customary interest rate and cross-currency swaps, but also entered into hedges against foreign exchange risks in connection with payments under the EPC contracts and trunk revenues (Valor Anual de Transmisión por Tramo, as defined under Chilean law).
- *Permitting related to the Changos–Kapatur transmission line* – Since permits required in connection with the construction of the 3km-long Changos–Kapatur transmission line (which is being developed by a third party) had previously been obtained by TEN, ancillary documents and special provisions addressing the issues that can arise from a split holding structure for the project permits had to be put in place. ■

Footnotes

1 – Comisión Nacional de Energía, 2016. Available in http://energiaabierta.cl/visualizaciones/capacidad-instalada/
2 – Ibídem
3 – Generadoras de Chile, 2016. Available in http://generadoras.cl/generacion-electrica-en-chile
4 – Coordinador Eléctrico Nacional, 2016. Available in https://www.coordinadorelectrico.cl/sistema-electrico-nacional/introduccion.html
5 – Engie Energía Chile SA, 2016. Presentation to Investors. 4Q 2016 Results. Available in http://www.e-cl.cl/prontus_ecl/site/artic/20160126/asocfile/20160126181724/4q16_presentation_eecl__1_.pdf
6 – All US$/Ps conversions have been made considering the Dólar Observado, as published by the Central Bank of Chile on December 16, 2016 (Ps 663.68)

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