

# ICHTHYS LNG – THE BIGGEST, EVER

IN THIS ARTICLE LATHAM & WATKINS, WHICH ACTED AS LEGAL COUNSEL TO THE EIGHT EXPORT CREDIT AGENCIES (ECAS) AND 33 COMMERCIAL BANKS PARTICIPATING IN THE ICHTHYS LNG PROJECT FINANCING, PROVIDES ITS INSIGHT INTO SOME OF THE NOTABLE FEATURES OF THIS MULTI-AWARD WINNING DEAL. BY **BILL VOGEL**, PARTNER, **MATTHEW BROWN**, PARTNER AND **ALEX COSGROVE**, ASSOCIATE, **LATHAM & WATKINS**.

Widely regarded as the largest project financing ever arranged in the international finance markets, the completion of the Ichthys financing was a highly significant milestone not only for Australia but for the project finance market globally. Driven by a sponsor group led by Inpex Corporation of Japan and Total SA of France, the Ichthys project shrugged off the global financial malaise to secure US\$20bn in limited-recourse financing, clearly demonstrating that, even in the current market, projects with sound financials and experienced sponsors will receive a warm reception from the world's financial institutions.

## Project outline

Located in the north of Australia, the Ichthys LNG project – with an expected capital cost of US\$34bn – incorporates a number of exciting firsts for Australia and the LNG sector. The central processing facility measuring 150x110 metres will be the biggest semi-submersible platform ever built and the first such unit of its type in Australian waters. A floating production, storage and offtake (FPSO) vessel will process project liquids and will have the capacity to hold 1.2m barrels of condensate.

The extracted natural gas will be transported to Darwin via a pipeline that will be the largest offshore pipeline in the southern hemisphere and one of the longest subsea pipelines ever built. The offshore component will stretch for approximately 890km. In total, construction of the pipeline will require approximately 700,000 tonnes of steel (enough to build 15 Sydney Harbour Bridges or 93 Eiffel Towers). The onshore LNG plant will comprise two trains with the capacity to produce 8.4 mtpa of LNG.

## Experienced sponsor group

As noted above, the Ichthys LNG project is owned by a sponsor group led by Inpex and Total, which have a history of collaboration stretching back 50 years. Inpex and Total collectively own approximately 96% of the project. Following the recent transfer of an additional 6% stake in the project from Inpex to Total, the ownership percentages of Inpex and Total in the project are 66.07% and 30% respectively.

The remaining ownership interests in the project are to be held by affiliates of certain

entities involved in the offtake of LNG from the project, being Tokyo Gas Co Ltd (1.575%), Osaka Gas Co Ltd (1.2%), Chubu Electric Power Co Incorporated (0.735%) and Toho Gas Co Ltd (0.42%).

## Efficient transaction management

For a financing of this size and complexity, the transaction was agreed, documented and closed in a very tight time-frame. Beginning in 2009, Total and Inpex worked to develop a structure that could accommodate external financing for the Ichthys project, as the sponsors' final investment decision required reasonable assurances that the project could be financed in part through external debt.

The financing teams of Inpex and Total first approached export credit agencies (ECAs) in April 2011 on the basis of a detailed financing term sheet (running to approximately 400 pages) previously prepared with the support of Allen & Overy, as legal adviser to the sponsors, and Crédit Agricole Corporate & Investment Bank and Mizuho Corporate Bank Ltd, as financial advisers to the sponsors.

After a year of negotiations with the ECAs, the resulting term sheet was released to commercial banks in May 2012. The full financing documentation package then took an additional six months to finalise with all core finance documents were signed by the participating ECAs and commercial banks in December 2012. The sponsors then satisfied the conditions precedent to funding in under six weeks – achieving financial close on January 30 2013 and first drawdown on February 15.

## LNG off-take and liquids marketing

The combined off-take volume of approximately 8.4mtpa has been marketed to regional LNG buyers in East Asia. Two Japanese consortia together account for almost 60% of the off-take, with CPC taking approximately 20%. The balance of the LNG off-take will be taken by the Inpex and Total groups. The project also will produce substantial amounts of LPG and condensate in addition to the LNG contracted under the long-term LNG SPAs. This liquids production will contribute significantly to project revenues, particularly in the early years of production. Condensate will be produced at a maximum rate

of around 85,000bbl/day at the field and a further 15,000bbl/day of plant condensate at the LNG plant at peak respectively. LPG production at the LNG plant is expected to be around 1.6mtpa.

Various trends point to a favourable environment for marketing condensate from the project. According to recent market reports, Asian oil demand is forecast to be faster and more sustained than the global average and growth in petrochemicals in Asia is forecast to outstrip dampened global expectations requiring more refinery naphtha and a strong and steady demand for various grades of condensate. With regard to LPG, Asia-Pacific is the world's largest market, making up around 70% of the total global LPG market, with consumption in the region expected to grow steadily.

Given the strength of demand for these products, the high level of liquids (condensate and LPG) production by the project is expected to contribute to project economics that are competitive with other projects that either have been recently completed or that are under construction – notwithstanding the relatively high capital costs associated with the construction, operation and maintenance of the off-shore facilities.

#### **One project – one cashflow**

Although much of the discussion to-date surrounding the Ichthys project financing has focused on the sheer scale of the transaction, the underlying commercial structure chosen by the sponsors for the project is an important feature that merits attention.

Unusually for a project finance transaction, the ownership of the project assets is split. The onshore/downstream facilities are owned by an incorporated special purpose vehicle (SPV) that also is the borrower under the project financing. The offshore/upstream facilities are owned pursuant to an unincorporated joint venture (UJV) structure – as is often the case for upstream oil and gas transactions. The use of the UJV structure also is a common feature of projects in Australia. Each sponsor has an ownership interest in the upstream project equal to its ownership interest in the downstream project – ensuring alignment of interests in all aspects of the project.

Although adding additional intricacy to the financing documentation, this split between upstream and downstream elements of the project was a necessary complication. A structure comprising only an unincorporated joint venture would have been more difficult to project-finance. A structure comprising only a single incorporated entity was not commercially efficient for the sponsors.

For example, the upstream UJV structure provides flexibility in the marketing of the condensate output of the project (a very fungible commodity) as it allows individual UJV participants to lift their respective condensate entitlement and market it to their existing clients. In contrast, the use of a single incorporated entity for the downstream aspects of the project streamlines the interface with the

LNG buyers and provides greater flexibility for expansion of the onshore facilities.

Given this split of asset ownership, one of the more notable features of this project and its financing is its “one project – one cashflow” philosophy, which also was designed by the sponsors and their advisers to ensure that the lenders have access to the entire cashflow generated – and to all the assets owned by – both the upstream UJV participants and the downstream incorporated borrower.

As noted above, the downstream incorporated entity acts as borrower for the entire project debt, a portion of which may be on-lent on a several basis to each of the upstream UJV participants (in proportion to their respective participating interests in the upstream project). Each UJV participant will sell its share of the feed gas produced by the upstream assets to the borrower, which in turn will produce the LNG and on-sell it to third-party buyers under long-term LNG SPAs. Each UJV participant also will receive revenues from its direct sales of condensate. All revenues of the borrower and the UJV participants are required to be paid into secured accounts.

Although the UJV participants do not provide a guarantee of the borrower's debt, the accounts structure and cashflow waterfalls are designed to ensure that cash available to the upstream UJV participants always is available should it be required by the borrower to meet its debt service obligations or to fund its debt service reserve account. Other features of the accounts structure ensure that cash can be moved between the upstream and downstream elements of the project – consistent with the “one project – one cashflow” approach.

#### **Project construction and operations**

The Ichthys project is also notably the first in the LNG sector with a Japanese operator. A subsidiary of Inpex (Inpex Operations) will undertake overall management of the project during both the construction and operations phases.

During construction, Inpex Operations effectively will act like an EPCM (engineer, procure, construct and manage) contractor for the project and its 10 principal contractors. The allocation of the ultimate management responsibility to a manager or operator entity (as opposed to a single contractor) is common in projects of this size and complexity and reflects the commercial reality that a contractor would find it very difficult to wrap the risk on such a project, even if the attendant risks could be accurately priced. The risks associated with this structure are mitigated by the sponsors' debt service undertaking during the construction phase.

Once construction has been completed, Inpex Operations will take on all day-to-day operations responsibility for the project.

#### **Environmental and social factors**

The environmental and social due diligence aspects of this transaction were complex, not only due to the size and complexity of the project but also

because of the multiple international standards to which the environmental and social risks were required to be benchmarked. These included not only the requirements of Australian law but also various international standards such as the International Finance Corporation Performance Standards on Environmental and Social Sustainability (the IFC Performance Standards).

The IFC Performance Standards are the most widely accepted framework among international project financiers for managing environmental and social risks. The ECAs also applied their own internal environmental and social guidelines, which largely incorporate by reference the IFC Performance Standards. Many commercial lenders applied the Equator Principles.

The IFC Performance Standards typically are applied in order to assess and manage environmental and social risks associated with project financings of large-scale infrastructure or extractive industries – being operations that have the potential to pose serious environmental and social risks. These projects are often located in the developing world, where environmental and social law may be limited, if not lacking altogether, and the application of the IFC Performance Standards and related technical guidance is similar to substantive environmental law.

The application of the IFC Performance Standards to a project located in Australia, an OECD High-Income country, was unique and posed its own set of complexities. Australia has a highly developed environmental and social legal framework and, in most cases, the requirements of Australian environmental and social law are more stringent than those of the IFC Performance Standards. Nevertheless, compliance with the IFC Performance Standards also was required and therefore any “gaps” between the two needed to be addressed by the project.

One major due diligence exercise was to identify the areas in which the IFC Performance Standards are indeed more stringent than the requirements of Australian law, and then ensure that the ECAs, lenders, project and independent environmental and social consultant were all comfortable with how those gaps would be documented or mitigated through an “Action Plan” to be implemented by the project.

#### Golden age of the ECA

As has been widely discussed in the press, a financing of this scale is impossible in the current market without significant ECA backing. The Ichthys project certainly provided ample opportunity for the participating ECAs to provide support for their domestic interests.

First and foremost, Ichthys is a Japan-orientated project. Ichthys is the first major LNG project in Australia since Japan revised its LNG needs following the 2011 earthquake and resulting Fukushima nuclear disaster. It also comes at a time when not only does Japan face a significant decrease in its LNG supply from Indonesia (a major LNG supply source for Japan)

but also a number of its long-term purchase contracts with other countries rapidly are approaching their renewal dates.

The significance of this long-term supply source to Japan enabled the Japan Bank for International Cooperation (JBIC) to support the project with its largest ever direct loan (in US dollars) to a single project. Nippon Export and Investment Insurance (NEXI) provided further significant commercial bank cover.

Japan has provided further support to the project through the state-owned Japan Oil, Gas and Metals National Corporation. JOGMEC was established in 2004 with the primary mission of securing stable supplies of oil, gas and metals for Japan and users around the world by supporting exploration and production, stockpiling and other initiatives.

One way in which JOGMEC supports such activities is to provide guarantees of Japanese corporate borrowings related to oil and natural gas exploration and production projects (including related natural gas liquefaction). In accordance with that mandate, JOGMEC has provided significant support to Inpex’s obligations under the several debt service undertaking provided by each of the sponsors to the project.

Of critical importance too was the involvement of Korea Trade Insurance Corporation (K-Sure) and the Export-Import Bank of Korea (Kexim), which stepped in to support their domestic contractors. South Korean contractors received major contract awards in respect of the Ichthys project and commercial bank funding for those contracts was supported by ECA cover from both K-Sure and Kexim. Kexim also provided direct funding to the project.

The other ECAs making up the rest of this impressive ECA line-up, providing a combination of direct funding and commercial/political risk coverage, are Export Finance and Insurance Corporation (EFIC) of Australia, Compagnie Française d’Assurance pour le Commerce Extérieur (Coface) of France, Euler Hermes Deutschland AG (Euler Hermes) of Germany, and Atradius Dutch State Business NV (Atradius) of the Netherlands.

#### Financing structure

The Ichthys financing ultimately comprised:

- US\$16bn of senior credit facilities, sub-divided into commercial bank facilities benefiting from ECA cover totalling almost US\$5.4bn; ECA direct lending facilities totalling just over US\$5.8bn; and an uncovered commercial bank tranche of US\$4.8bn.
- US\$4bn in senior sponsor credit facilities, comprising either senior debt provided by commercial banks and backed by sponsor cover or provided directly by the sponsors (or their affiliates). Unlike the sources of senior financing listed above, these senior sponsor credit facilities do not benefit from the sponsors’ debt service undertaking.

In addition, certain of the equity requirements for the project will be met through the provision of subordinated loans provided either by commercial banks and backed by sponsor cover or provided directly by the sponsors (or their affiliates). ■