Shuaibah template

PFI Yearbook 2006

The US$2.5bn Shuaibah IWPP is a landmark transaction and the culmination of nearly four years of work. By Tariq Al-Betairi, Chairman, and Omar Al-Ghamdi, President, of Water & Electricity Company LLC.

The first IWPP in Saudi Arabia is also the world’s largest new build IPP/IWPP and the model/template for the Water & Electricity Company (WEC) IWPP programme, which will procure the capacity to meet a significant portion of Saudi Arabia’s future water and power demand. On November 15 2005, WEC and Shuaibah Water and Electricity Company (the project company) signed the power and water purchase agreement (PWPA) for the project company to build, own and operate the 900MW and 880,000 m3/d Shuaibah Independent Water and Power Project (IWPP).

The project company is targeting the signing of US$2.5bn of supporting debt (commercial, Islamic, export credit) and equity bridge facilities (EBFs) during December 2005, with first drawdown of funds expected in early January 2006.

Upon financial close, the Shuaibah IWPP will represent the following:

- The world’s largest new build IPP/IWPP;
- Saudi Arabia’s first IWPP and largest independent power project;
- The world’s first oil-fired IWPP, and wholly-compliant with the requirements of the World Bank and the Equator Principles; and
- Financed with, among others, 20-year loan tenors (a Saudi record and joint GCC record) and six-year EBF tenors (a first for Saudi Arabia and a GCC record tenor).
- The signing of the Shuaibah PWPA will be followed very shortly by the issue of requests for proposals (RFPs) for WEC’s second project - the 850MW and 212,000 m3/d Shuqaiq IWPP, for which 13 applicants have been pre-qualified.2 WEC’s next IWPP in the development pipeline is the Raz Azzour IWPP.

Objectives

The Saudi population is increasing by around 3% per annum and the west coast region (where Shuaibah is located, 110km south of Jeddah) is the most populous region in the Kingdom and one of the fastest growing. Increasing population and continued economic growth means a high demand for water and power (eg, national peak load increased by 6% in 2004).

Therefore, the Shuaibah IWPP was necessarily going to be a large project, with the high demand for water being the key driver of project scope.

The requirement to utilise light crude oil as the project fuel (the west coast has little gas infrastructure installed) in addition to the large desalination component meant the project’s capital costs would justifiably be materially higher than the ‘first’ project undertaken elsewhere in the GCC, and it would be the world’s first oil-fired IWPP.

The initial project scope was 600MW–850MW and 800,000 m3/d (176 MIGD), meaning a water component 76% higher than the previous largest GCC IWPP new build - the Shuweihat IWPP, Abu Dhabi, (100 MIGD). However, revised population and demand/supply projections entailed an increase in the project capacity to the ultimate 900MW and 880,000 m3/d (194 MIGD) - almost twice the water capacity of Shuweihat.

The project’s water exports will serve increasing demand in several major west coast cities, namely Makkah, Jeddah, Taif and Al-Baha while power will be exported to the western region grid. Therefore, given the strategic importance to Saudi Arabia, it was very important that the project was correctly and successfully procured at the first attempt. We believe the initial vision of how to do this and the process through which the project has been executed is a tribute to the Saudi stakeholders involved and the advisory team we selected to perform this.

Saudi Arabia initiated the Shuaibah development process in late 2002. At that time, there was some IPP/IWPP precedent within the region (for example, projects had reached financial close in Abu Dhabi, Oman and Qatar) and smaller, cogeneration IPPs were under development by industrial entities within Saudi Arabia (namely the SADAF IPP and Saudi Aramco’s Cogen projects), although the regional IPP model was not as established as in 2005.
In this early phase, Saudi stakeholders evaluated, at a high-level, differing regional approaches in formulating the architecture of the WEC IWPP programme - the Supreme Economic Council’s Resolution 5/23 (of which more below) - and also drew upon Saudi Arabia’s experiences from, and discussions with, international oil companies concerning Core Ventures 1–3.

Fundamentally, Saudi Arabia’s key objective for Shuaibah was to procure the required water and power capacity to the highest market standard and to create a world-class precedent, so as to form a template for the overall WEC IWPP programme which will be rolled out over the next few years.

From an internal perspective (ie, within the Saudi stakeholder organisations), we built the necessary cross-organisational consensus to enact the required enabling legislation, Resolution 5/23 (passed in 2002), which is the key legislative component of Saudi Arabia’s IWPP programme and provides that:

- The projects will be developed on a BOO basis and will adopt the energy conversion agreement model;
- The contractual off-taker (and fuel supplier) will be a limited liability company (WEC) in which SWCC and SEC each own a 50% stake;
- State credit support will be made available in respect of the projects;
- Saudi Arabia will own a 32% stake, and Saudi Electricity Company (SEC) will hold 8%, in each project company;
- A joint team from Saline Water Conversion Corporation (SWCC) and SEC (under the supervision of SWCC) will prepare and supervise the bid process for the projects (acting as the tendering authority);
- Tenders will be assessed according to five principal criteria (price, capacity, Saudi employment, technical performance and use of local goods and services); and provided that
  - Certain incentives will be made available to the project companies (reduction of required statutory reserve rate, industrial activities privileges, nominal rents under site leases).

In executing the objectives of Resolution 5/23, we staffed WEC (the off-taker and tendering authority) through seconding highly capable and committed staff from SWCC and SEC (certain of whom had previously worked on the Core Venture developments) and appointed designated link personnel within other stakeholder organisations, as being responsible for liaising with the WEC IWPP programme.

From an external perspective (ie, in relation to the developer and financing markets), we intended:

- To develop, following a rigorous conceptual process, a contractual structure designed to appeal to international IWPP investors (and their lenders) while meeting core Saudi stakeholder objectives and requirements;
- To develop and execute a transparent, privatisation tender process in line with leading international practice;
- In executing Resolution 5/23, to craft optimal, robust and bankable state credit support underpinning WEC’s payment obligations, designed to be bankable and investor friendly while meeting public policy requirements; and
- To make an early appointment of appropriately experienced external advisers to support the programme. We aimed to carefully select experienced multi-disciplinary advisers with devoted, able people who understood our objectives and requirements, and who had the experience and skills to develop and execute what was needed.

In May 2003, HSBC (financial), Clifford Chance/Al-Jadaan (legal) and Fichtner (technical) were appointed as advisers to WEC, with a brief to execute the above objectives. HSBC was appointed as co-ordinating adviser with a clear understanding that it was assigned the responsibility to manage and direct the project development advisory teams and the tender process to a successful conclusion.

Pre-bid

**Concept report** - The early part of the Shuaibah transaction comprised the preparation, review and discussion of a concept report (prepared by the advisers). The report was a large, multi-disciplinary document that analysed various pertinent issues in relation to the project as applicable to Saudi Arabia’s circumstances (eg, GCC IPP/IWPP precedent, contractual structure, financing structure, risk allocation, technical concept), before providing recommendations on each aspect.

The final report was widely circulated among stakeholders and, following its approval in July 2003, the report’s findings fed directly into the selected tender process and the RFP preparation.

**Tender process** - The Shuaibah IWPP tender process

was designed to provide the largest opportunity for developers to participate (and finance parties to be aware of the transaction). The process encompassed the following stages:

- Requests for expressions of interest (published in international media);
- Requests for qualification (following receipt of 14 statements of qualification, WEC pre-qualified 11 applicants to receive the RFPs);
- Following release of the RFP on July 31 2004 we held a pre-bid conference (involving a detailed presentation by WEC/its advisers on the RFP, public questions and answers), followed by bilateral meetings with each applicant. We used of a common website to handle questions from applicants and the publication of new information, with all answers made in the form of common replies.
And given the size of the project and the potential use of ECA finance by bidders, WEC visited each ECA approached by potential bidders, to outline and discuss the project with a view to maximising the competitiveness and advanced nature of any supporting ECA proposal.

RFP - In preparing the Shuaibah RFP, WEC and its advisers made several key choices at early critical stages, and these ultimately promoted a successful transaction, namely:

- Corporate structure: The project company was to be formed as a joint stock company, for liability and flexibility of financing motivations. To speed up the incorporation process, the minority shareholders, Public Investment Fund (PIF) and SEC, would form the company, with the successful bidder acquiring a 60% majority stake for nominal consideration. A Royal Decree was required to formalise the process and the incentives intended to be granted under Resolution 5/23;
- PWPA: The PWPA to be offered to the market was intended to provide the following benefits to investors and their supporting lenders; purchase by WEC of 100% of water and power capacity and output under a 20-year PWPA; conventional, clearly defined tariff structure divided into capacity and output charge elements; supply of light crude oil by WEC on an energy conversion basis; depending on the cause and timing of termination, termination payments sized to repay outstanding debt and equity (including an equity return); and a supporting risk allocation broadly in line with GCC regional precedent.
- Credit support: Under a support agreement, the Ministry of Finance agreed to guarantee the payment of all undisputed payments under the PWPA, namely each invoice due and payable, as well as any termination payments. This guarantee structure - unique in the GCC - was developed as it had two key benefits. First, from a developer/lender perspective, it provided the greatest certainty of payment for all payments (small or large, regular or irregular) with the maximum boost to bankability. Second, from Saudi Arabia's perspective, it minimised the potential for a hair-trigger payment default (as a missed invoice payment could always be remedied) and required a long-term close involvement with the project. Importantly, from a public policy perspective, the guarantee was governed by Saudi Law and dispute resolution. On July 26 2004, the Council of Ministers approved the credit support for all four projects under WEC's IWPP programme
- Shareholders agreement: From a financing perspective, the shareholders agreement enabled bidders to propose the use of EBF and/or shareholder loans. From an investor flexibility perspective, all external investors (other than a designated technical investor) are able to transfer their shares relatively swiftly after completion, with a sliding-scale transfer mechanism applicable to the technical investor. Each of the minority shareholders, PIF and SEC, are enabled to transfer their interests through means of an IPO at a holdco level.
- Financing requirements: WEC and its advisers were keen to draw upon the high capacity and capability of the Saudi banking market, without causing well-connected bidders to potentially restrict the supply of finance on the most competitively possible basis. In parallel, to maximise potential sources of liquidity and to ensure the most competitively possible pricing of finance, WEC wished to promote international lender involvement and take account of potential ECA involvement. Consequently, bidders were required to secure support from a minimum of one international finance party and a maximum of two Saudi finance parties, with a sliding-scale, partial underwriting requirement varying according to whether ECA finance was proposed.

Post-bid and looking back

Throughout the majority of the seven-month tender period, three bids were expected for the Shuaibah IWPP from international bid teams. However, as emphasised at the pre-bid conference, WEC confirmed there was no requirement to receive a minimum number of bids and that a single bid, if judged competitive, would be acceptable to WEC.

On March 5 2005, WEC received a compliant bid from Saudi-Malaysian Consortium (a JV comprising Tenaga Nasional Berhad (TNB), Malakoff Berhad (Malakoff), Khazanah Nasional Berhad and ACWA Power Projects) to build, own and operate the US$2.5bn 900MW and 880,000 m3/d Shuaibah IWPP. Saudi-Malaysian Consortium’s bid was supported by a multi-sourced financing plan including commercial, Islamic, ECA (Kexim and Hermes) and EBF financing.

Following the bid evaluation and clarification phase, on June 15 2005, Saudi-Malaysian Consortium was selected as first ranked bidder by WEC, which led to the negotiation of the draft agreements. The first ranked bidder - Saudi-Malaysian Consortium, was an excellent amalgam of local (through ACWA Power Projects) and international expertise, with established technical investors in TNB and Malakoff.

As noted above, a key aspect of the project was the need for a Royal Decree formally to incorporate the project company. On August 15 2005, upon Council of Ministers Resolution No.180 dated 10/7/1426H, Royal Decree No M/43 dated 11/7/1426H was issued to incorporate the project company, a major project milestone.

After initialising the draft agreements on October 23 2005, the PWPA was signed in Riyadh on November 15 2005. The finance documents will be signed in December 2005, with first drawdown expected in early January 2006.

Looking back at the RFP issued in July 2004, first, it is clear that the package carefully prepared by WEC and its advisers was broadly acceptable to, and accepted by, the developer/financing market and has led to highly competitive and substantial offers from the market (eg, 20-year debt tenors).
Indeed, there are only two real variances between the PWPA presented in the Shuaibah RFP and the final Shuaibah PWPA, namely:

- The PWPA will now be governed by English law; and
- Under the PWPA, WEC will provide the project company with ‘unenforceability protection’ against the risk of Saudi parties contractual obligations being deemed unenforceable by the Saudi courts.

Both of the above will be incorporated into the Shuqaiq RFP from the outset, which we envisage should lead to an even stronger market response for Shuqaiq.

Second, from private and public feedback received from the developer and financing markets, it seems the market consensus is that the Shuaibah IWPP tender process (developed by WEC and its advisers) is considered to have been highly transparent, of integrity and extremely responsive to developer/lender requirements. WEC confirms the same process will be utilised for the Shuqaiq bidding period.

**IWPP pipeline**

As noted above, the RFP for the Shuqaiq IWPP will be issued in December 2005 (to 13 pre-qualified applicants). Consistent with the objective of the Shuaibah IWPP being the template for the WEC programme, the RFP will be generally consistent with the agreed contractual position for the Shuaibah IWPP, with one new mechanic intended to promote investor interest in Shuqaiq (a 49% minority post-completion Bidder IPO). The bid submission date for the Shuqaiq IWPP is July 2006.

Moving forward, after the substantial progression of Shuqaiq, it is planned that WEC will next issue the RFP for the 2,500MW and 800,000 m3/d Raz Azzour IWPP. This project marks two changes for WEC, as it will be on the east coast of Saudi Arabia and will be gas-fired. Nonetheless, it is expected that the structure of the project will resemble that adopted for the Shuaibah and Shuqaiq plants.

**Conclusion**

The Shuaibah IWPP is an excellent example of an international privatisation process whereby a sovereign client with a substantial underlying demand requirement, solid and pronounced stakeholder support and clear, consistent objectives, can work closely with experienced, able and committed private sector advisers to successfully develop an IPP/IWPP structure and tender process, resulting in the realised, US$2.5bn Shuaibah IWPP project financed deal.

Since the initiation of the Shuaibah IWPP process in 2002, the macro position of Saudi Arabia is widely perceived to have improved from an international perspective (eg, through WTO entry, continued economic growth and budget surpluses, reflected in credit rating agency upgrades).

Accordingly, following a successful closing of the Shuaibah IWPP, this bodes well for strong market interest in the forthcoming IWPPs, with Saudi Arabia expected to be one of the world’s most active and attractive IPP/IWPP markets in 2006 and 2007.