H.K. Genco

A Case Study in Financing an Electric Power Project on a Fully Non-Recourse Basis

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Abstract

The electric power industry makes use of project financing as a means of leveraging project capital structures. This approach seeks to take advantage of regulatory schemes that provide predictable tariffs and cash flow for debt service. Power projects are then approved on the basis of “Leveraged Economics,” with the critical metric being sponsor’s Return on Equity. The economic soundness of this approach rests on the project debt being non-recourse to the sponsor, i.e. project lenders have no recourse to sponsor’s other cash flow or assets if the project defaults on its loans.

H.K. Genco (HKG) is the case of an established Asian utility that successfully employs this approach. HKG’s regulatory structure, the Scheme of Regulation (SR), was well crafted; it has successfully supported HKG through successive plant constructions. Now HKG is seeking financing for a new project, Crown Peak. This project and the associated financing will be HKG’s largest to date.

Though the SR remains in place, a major transition is occurring in HKG’s market, Makong. Currently a colonial possession, Makong is due to revert to Midking within a few years. Lenders are now asking HKG’s parent companies, Flagler Corporation and Makong Light and Power (MLP), for assurances that the SR will not be altered. Some comfort has been provided by Midking officials; however loan syndicate arrangers have now written directly to Flagler and MLP seeking representations that the Sponsors are not aware of any facts indicating that the SR may be changed. They also want the Sponsors to clarify their intentions in the event the SR is later changed.

The case explores the tension between business strategies that rely on non-recourse financing and the efforts of lenders to secure at least limited recourse to project sponsors. Particular attention is given to the ways in which lenders seek formal and informal comfort from sponsors and to the significance of sponsor representations in this context. The case raises questions of how sponsors should respond to lender demands for clarifying statements regarding hypothetical future scenarios. It also poses the issue of whether the sponsors’ appropriation economics are still valid if they give lenders too much comfort.