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TITLE

INVESTMENT PROTECTION IN NON-RECOURSE PROJECT FINANCE: THE LENDER'S PERSPECTIVE

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ABSTRACT

Project finance, as a non-recourse (or limited-recourse) financing model has been gaining significant popularity in international projects, especially in developing countries within the past decades due to its unique structure and specifications, which contrast traditional financing methods. Due to the model's non-recourse nature, however, project lender, while assuming higher returns, also assume higher risks, having the possibility to claim security solely over project assets and project cash flow. This paper examines and reviews certain security methods in non-recourse project finance available to the lenders, as well as possible differences in the legal framework related to these remedies in different jurisdictions.

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INTRODUCTION

Any sorts of investments are associated with risks to some degree, which is why parties who invest or lend funds for specific business purposes should be prepared for scenarios that might result in substantial loss. Nonetheless, these risks are minimized to some extent in classical recourse financing, as opposed to limited-recourse or non-recourse financing structures used in project finance. Classical non-recourse project financing, for instance, does not impose upon the project the owner any obligations to guarantee the repayment of the funds lent to the project in scenarios where project revenues end up being insufficient to cover the principal and interest payments. In essence, this structure only assumes repayment of the project out of the revenue stream generated from the project itself. The nature of such structures provides financial independence to each project, and protects the project owner's general assets. This implies that in a typical non-recourse project finance structure the lender of the loan can solely rely on the project collateral in the enforcement of obligations. Hence, this raises an issue: what happens, if the project fails to generate enough revenue for covering the funds invested, or to make any revenue at all?

Although there are no significant legal efficiency differences in security between project financing and other financing structures, the economic efficiency is quite different. As such, project finance, is a technical, complex, high risk structure, and, naturally, there is a wide range of existing functional security instruments in project finance. It may be argued that, since project financing

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does not have a specific universal legal framework to regulate issues arising in the cases using this financing model, the scope of security remedies should be purely managerial or financial. Nonetheless, project financing is equally as reliant on certain legal aspects due to the fact, that as a sphere regulated on case-by-case basis, this financing model is extremely heavily reliant on its contractual package, which is both the main asset and the legal instrument regulating the project in question. This thesis paper will examine the various available tools and structures for investment protection in projects in case of project failure or malperformance from the project lender's perspective, their application in different types of legislation, and discuss their efficiency in infrastructural, particularly BOT model projects financed through non-recourse project financing.

What are the principles of the lenders' investment protection, what remedies are available for these purposes, and how do they apply in different types of jurisdictions, when dealing with projects financed through a non-recourse project finance model?

Being as risky as it is, the involved parties may find certain significant advantages and, hence, incentives to resort specifically to this type of financing instead of classical financing methods. Briefly speaking, this structure is quite popular in and proves to operate especially efficiently for infrastructural projects in developing countries, as well as oil and certain services related projects, including but not limited to hospitality and health care. Primarily, the model allows for minimal equity investment, which would be somewhat problematic or impossible to certain extent within the scope of classical financing structures. It also permits the interested parties to develop several projects in different areas simultaneously, by "locking in" the recourse to each project individually, which allows them to remain independent of the financial obligations of other projects. The system is especially popular among established and well-capitalized large corporations, which prefer to assist in undertaking large debt commitments and generate higher returns than it would be possible in classical financing structures, and governmental bodies of developing countries with insufficient available financial, informational and other resources, which, nonetheless, aim to support infrastructural development. The advantages to this type of financing, as well likely incentives of its usage will be discussed in more detail below.

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Despite the advantages, however, project finance structure, naturally, has its demerits in that it is quite costly to assemble, is complex, and bears higher risks in comparison with conventional financing routes. The lenders of the capital invested in the projects, despite the perspectives of receiving much higher returns than in case of traditional methods of financing, bear even higher risks. This is why, in a system as complex as project financing, it is crucial to effectively allocate and minimize possible risks, thus offering the lenders efficient techniques to protect their funds in scenarios where the projects fail to generate enough profit to cover its debt, or fails to generate any profit at all.

The main aim of this paper is to discuss and evaluate the available tools and security options for backing up the lender's financial resources in case of complete or partial failure of the projects. Due to technicality and the complex nature, international projects, which make up the majority of the projects financed through this structure, have their own challenges and requirements, and deal with conflicts of laws, along with project-specific issues depending on the nature of the infrastructural nature in question. The focus of this paper will fall on remedies and risk allocation principles to be implemented or initiated by the project lenders themselves, in order to protect the invested funds, therefore, insurance and third-party financial guarantees will not be covered. The paper discusses security in non-recourse type models within the scope of project financing, specifically those within the BOT general framework, used in, but not limited to, the vast majority of infrastructural, oil, mining, hospitality, healthcare, township and other projects.

The literature, which this paper is based on and refers to includes a wide array of scholarly papers, research articles, certain legal regulations, and web-based informational resources. The list of main pieces of academic literature, which have had a valuable impact on this research, are briefly reviewed below. Other sources referred to in this paper can be found in the "Bibliography" section.

The latest edition of the article "A Guide to Project Finance" by Dentons Law firm, revised on August 2018, which was created with the contribution of Neil Cuthbert, has a significant contribution to the research and the information provided in this paper, as it provides an in-depth,

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comprehensive understating on the basics of project financing, peculiarities associated with this financing model, covers the differences between civil and common law jurisdictions concerning certain security tools, as well as touches upon the role of all the parties involved in large-scale infrastructural and other projects. The guide also provides information on various project structures and examines the issues of security and risk allocation both in limited-recourse and non-recourse project finance.

“International Project Financing as Contractual Risk Minimization Arrangements” by Tero Erme, published by University of Helsinki, provides an excellent overview of risks in international project financing, and focuses on the aspects on the security tools available for lenders through the contractual package of international projects. The work covers both limited and non-recourse remedies as well, and provides an in-depth analysis for each in different types of jurisdictions.

“Legal Risks in International Project Finance”, a dissertation by Ngalim Bernard YONGABIhe, Zhongnan University of Economics and Law, focuses on investigating and analyzing the legal risks in international project finance, and determines the primary legal risks that may hinder the success of international privately financed projects and discusses the available regulatory framework for international project finance.

“International project finance: Review and Implications for International Finance and International Business” by Jakob Müllner is a literature review, which analyses the global phenomenon of international project finance from managerial and financial perspectives, as well as defines and describes the model’s main characteristics and provides information on its historical origin.

"Project Finance, Subordinated Debt and State Loans" by Philip R Wood reviews the structures involve in international project finances, and covers issues related to the host government (state), lending to international organizations and subordinated debt finance.

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SECTION I

PROJECT FINANCING: DEFINITIONS AND FUNDAMENTS

In the field of commercial banking, the term "project financing" is generally defined as lending to a project (typically to a special purpose vehicle) where the lender expects to be repaid principally from the cash flow generated through the project's operations, having security claims solely over the revenue stream and the assets of the project. In essence, project financing is a financing model on a limited or a non-recourse basis, where repayment either completely or mostly depends on the project's cash flow. This financing model is arguably dated back to Roman times, and is behind such historical projects such as the Suez Canal[1] and Trans-Siberian Railway [2]. The peak of the model's popularity, however, has started in the late 1980-90s, with the increase in the number of mostly infrastructural projects in developing countries. Project financing has multiple and complex linkages to the economy, as it involves a large expenditure flow, and may create positive and

[1] Beidleman CR, Fletcher D, Vesbosky D (1990) On allocating risk—the essence of project finance. Sloan Management Review; Cambridge Vol. 31, Iss. 3, (Spring 1990) 47–55

[2] Available at: http://www.scribd.com/doc/16634080/Introduction-to-Project-Finance-1 , Last visited, 10th May 2019

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negative externalities through having direct effects on production and consumers, with the scope and significance depending on the nature of specific projects.

The principle of limited or non-recourse financing, as the key difference between traditional financing and project financing, was recognized by the English courts in the case of *Williams v. Hathaway (1877) 6 CH D 544*, where a railway company paid the fund to the vicar of a parish and the incumbent of an ecclesiastical district in accordance with an Act of Parliament which assigned the recipient of the fund to construct a new church and parsonage, and later provide those to the railway company, the financier[3]. The cost of the construction works exceeded the monies in the fund and the builder (recipient of the fund) took legal action to recover the deficiency. Despite the fact that the contractual arrangements were made with the individuals who were the trustees of the fund, it was ultimately held that "the object [of the contractual instrument] is to bind the fund"[4] and not the trustees in their personal capacity.

The US Financial Accounting Standards Board (FASB) defines project financing as follows: "The financing of a major capital project in which the lender looks principally to the cash flows and earnings of the project as the source of funds for repayment and to the assets of the project as collateral for the loan".[5]

Project financing model can be characterized by a considerable number of parties with various interests, and with many projects, especially those on a larger scale, there will be an international element involving parties located in different jurisdictions, hence creating a layer of complexity in relation to the overlap of laws and regulations of different countries. The three principal parties of this financing model are presented and discussed below.

The Project Company (Borrower) is normally a special purpose vehicle, partnership, joint venture (or a combination of these, depending on the regulatory and legal framework of the host

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[3] Williams v. Hathaway (1877) 6 CH D 544
[4] Id.

[5] Statement of Financial Accounting Standards No. 47: Disclosure of long term obligations. March 1981

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government). In certain cases, the Project Company can also be **the Project Owner**, which is the entity that initiates the project, and will hold the possession of the project, once the project debt and other financial obligations are repaid. The project company is, in most cases, the vehicle that is raising the project finance, is granted the concession or license (in types of projects where these are applicable). Where the project owner is a separate entity from the project company, for example, a host government in public-private partnership projects, the project owner will be the party granting a certain license (e.g. a mining license) to the project company. Some jurisdictions may require this company holding the license or concession to be incorporated in that particular country. For example, under Mongolian Licensing and Mineral Laws, a foreign person or legal entity cannot directly apply for and hold any mining licenses in Mongolia, and may only do so by incorporating a company in Mongolia or investing in a joint venture with a local partner[6].

The Project Sponsors/Developers are companies, agencies or individuals who are interested in the successful development of a certain projects, will benefit from it economically or otherwise [7], and are the ones to undertake the development of the particular project, obtain the necessary permits, agreements with all the parties to be involved for the purposes of the realization of the project. The project sponsor is critical to successful implementation of project objectives, with a crucial role in project financing structures, as this is the party primarily responsible for the project's success, and essentially the party which "connects" all the other parties. Generally, this is the party responsible for securing financing, construction, operation, and maintenance and all the activities related to the development of the project, usually also including support in providing management and technical assistance to the project company.

The Project Lenders are usually banks or other financial institutions, which will finance the project. In large projects the lender is rarely a single institution, since most lenders prefer to allocate their investment in multiple different projects, rather than take upon financing only one large

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[6] ICLG, Section on Mongolia Mining Law, (*3.2 Can the entity owning the rights be a foreign entit or owned by a foreign entity and are there special rules for foreign applicants?*), also available at https://iclg.com/practice-areas/mining-laws-and-regulations/mongolia, Last visited May 10, 2019

[7] Peter K Nevitt and Frank Fabozzi, Project Finance, 3 (6th edition, Euromoney Publications, 1995)

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project, and thus minimize risks through the diversification of the financial resources invested. Moreover, the scale of many international projects does not assume financing by a single lender and by these reasons syndicates of lenders are a popular occurrence for the purpose of financing projects.

At the first glance risk management may seem to be a combination of primarily financial and managerial phenomena. Nonetheless, in practice, it is equally a legal one, as the levels of risks the participants of the project undertake is directly and heavily dependent the contractual network of the specific project. The **contractual package** is both one of the most essential tools in project financing, and one of the most crucial assets of projects financed through this structures, as it establishes and provides the risk-related rights and obligations among and to the projects participants, as well any other regulations concerning any unique peculiarities of the particular project. This is due to the fact that each individual project has its own specific characteristics and involves a unique set of risks and conflicting interests among the parties.[8] The legal documents of project financing arrangements, therefore, are designed on a case-by-case basis in order to meet the requirements of the particular project in question. There are no standard structures, forms, guidelines, standard contracts, general rules or conditions for project financing. For international project financing especially, which includes the vast majority of projects financed through this model, by the reasons mentioned above, there are no uniform or universal laws and regulations for international project financing, which makes it both particularly interesting and tricky form a legal perspective. By these reasons, the contractual package is of crucial importance to any project financing arrangement, as it forms both the "brain" and the "spine" of any project, regulates it, and simultaneously serves as one of the most important assets of the project, by providing all these legal rights and obligations to the parties.

However, multilateral organizations, including World Bank, the Asian Development Bank, the United Nations Commission on International Trade Law, and others, have developed guidelines and

[8] Heinrich Harries, The Contract Law of Project Financing, in The Law of International Trade Finance, Volume 6, (Norbert Horn ed. 1989), p 350.

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procedures, which serve as the basis for international project finance regulation. These organizations assist in regulating and guiding the legal framework of relationships involved in international projects, which may be concerned with several jurisdictions at the same time. For instance, the United Nations chartered the United Nations Commission on International Trade Law to remove trade barriers among countries with different legal systems. [9]

The Legislative Guide on Privately financed Infrastructure Projects was published by The United Nations Commission on International Trade Law in 2000, and is designed to provide a set of legislative recommendations, which can assist in establishing a legislative framework that could benefit privately financed projects.[10]

Despite the lack of universal and specific standard laws and regulations covering project financing, there are also certain basic legal instruments and concepts which are frequently used in project financing arrangements. There are four essential areas of legal relationships of special importance to project lenders, which can be identified on this basis, and are briefly presented below.

First comes the relations between *the project company, the project sponsor and the project lenders*, normally determined by the legal instruments of project loan and security agreements.

Another important legal relationship is the relations between *the project company and the buyers* of the project's end product (or service, depending on the nature of the project), which should ideally be determined through long-term sales agreements.

The relations between the project company and its suppliers or service providers, is of equal importance, and is determined by the supply/service agreements.

[9] Scott L. Hoffman, The Law and Business of International Project Finance

[10] UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, prepared by UNCITRAL

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Ultimately, if a project is financed through a syndicate of lenders, which is the case for largest international projects, *the relations between the project lenders*, determined by the inter-creditor agreements, is of a significant importance as well.[11]

Reasons Project Financing is Used, and the Demerits of the Model

As presented above, project financing is a specific type of a financing model, which comes with certain advantages and demerits, as well as unique characteristics, which may serve as an incentive for the interested parties to adopt this model for specific projects. It is a common financing structure option due to the following reasons, either exclusively or collectively.

First and foremost, the model provides with a framework and a possibility to finance large scale projects using very highly leveraged debt, which essentially means that in the debt to equity ratio of a certain project, the volumes of debt are significantly higher than equity, meaning, that the financing is dominantly reliant on debt in very large volumes, which, in some cases makes it impossible to resort to traditional financing due to varying debt to equity ratio restrictions.[12]

The model, therefore, also permits the project developer to avoid restrictive covenants, such as debt coverage ratios in loan agreements, as the project financed is separate and distinct from other operations and projects of the developer, and, therefore, due to the distinct nature of the project financed, the model permits the developer to leverage debt to an extent that would have been prohibited by other existing financial agreements, through financial covenants of its corporate loan documentation or borrowing restrictions in statutes[13]. In some jurisdictions, where the legislation requires the project assets to be owned by the special purpose vehicle incorporated in that jurisdiction, for example, the developer may be indirectly forced to adopt project finance model.

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[11] The list of the relationships is based on the division of main legal fields in project financing in Harries, 350

[12] Harries, 347

[13] Investopedia, Investing, Financial Analysis, DSCR *(What is DSCR?),* also available at https://www.investopedia.com/terms/d/dscr.asp, last visited 10, May, 2019

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For project owners, which can be host governments, especially in infrastructural projects in developing countries, the model may be a good choice for attracting private foreign investment, without investing own limited financial resources, which gives room for prioritization of other concerns. The model also gives the opportunity of acquisition of foreign private sector skills and experience, education and training for local labour, and provides with possibility of development for otherwise non-priority projects.[14] Where the project owner is not a government, but rather a physical or a legal person, this model gives an opportunity to establish a potentially profit generating project without investing own financial resources, whether there are none available or the availability is limited, and, hence, without risking own financial resources.

From the lenders' perspective, project financing is selected in many circumstances primarily due to very attractive interest rates and higher return margins, which is naturally due to higher risks involved in non-recourse financing models. In other words, the lenders' "willingness to assume higher risks inherent to project financing can be compensated by higher margins of profit" [15]FIN page 304

With all the advantages and incentives for resorting to project financing, however, this model has its own demerits, which is where the importance of using efficient risk allocation methods and selecting effective remedies comes forward. Project financing revolves around extremely complex transactions involving many participants, often situated under different jurisdictions, with diverse interests, and this complexity naturally raises the risk allocation tensions between all the parties involved. This high risk scenario results in higher fees charged by the project lenders, as well as in an expensive process of due diligence conducted by the lender's counsellors. Evaluation of the project and negotiations of the complex project documentation and contractual package by the lender's technical experts and lawyers make project finance significantly costlier than conventional

[14] Dentons, "A Guide to Project Finance", August 2018, 6

[15] Tero Erme, "International Project Financing as Contractual Risk Minimization Arrangements", 2000, "Helsingin yliopiston kirjaston verkkojulkaisu 2010", 304

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corporate financing. Moreover, monitoring of the technical progress and performance of a project is also quite costly.

SECTION II

THE BOT MODEL AND VARIATIONS

Build operate transfer is a non-recourse project financing and operating model that currently is popularly applied in the area of infrastructural projects mostly in developing countries, as well as to areas, such as mining, hospitality, education, healthcare, and others, by enabling direct private investment in large scale projects. There is a number of varieties within the BOT model family, depending on the needs and specifications of particular projects, some of which include DBOT (design, build, operate, transfer), BOOT (build, own, operate, transfer), BLOT (build, lease, operate, transfer) and many more. [16]

BOT based structure is a concession (license or similar interest) based model. The key features of this model, therefore, include the grant of a concession, the undertaking of the project developer, a private sector organization, to design, construct the particular infrastructure, secure financing, operate the project and re-transfer the project assets upon the expiration of the concession period, normally ranging from 10 to 30 years, to the grantor of the concession (usually, but not always), the host government, who acts as the owner of the project. In cases where the project owner is not the grantor of the concession, it is the entity that holds the concession, which can be another private legal entity. The revenue generated by the project will be used to repay the loans, operate the concession and recover the investment of the developer, with the addition of a certain profit margin.

This is the basic structure of the BOT model, which in other variations, such as BOOT, can also involve an ownership element, where the developer can own and possess the project assets to be

[16] Available at: http://www.scribd.com/doc/16634080/Introduction-to-Project-Finance-1 , Last visited 10th May 2019

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constructed, and operate them within the concession period, generate sufficient revenue through the project to repay the project loan and its own fees/compensation within this period, and upon its expiration transfer the ownership and possession of these assets to the grantor of the concession/ holder of the concession.

Main Categories of Risks

Due to the nature of project financing, where project's revenue and assets are to serve as the source of debt repayment, the project lenders can only expect to recoup the funding lent to the project and gain adequate compensation, if the project generates a sufficient cash flow to cover all the operation costs and the debt service. Hence, the lenders assume the same risks as equity investors would, with the difference of having priority rights to project assets as creditors. There are certain principal categories of risks which may be of concern to project lenders, as there is a possibility those can interrupt the project's revenue stream or reduce the value its project assets.[17]

Completion risk

This is one of the most major risks in the project’s life. If the construction of the project is never completed, the project, as a result, never generates any revenue, and hence the debts to the project lenders are never paid [18] A less extreme form of completion risks can be delays in completion of the construction, which threaten the viability of the project and/ or can result in cost overruns caused by delays[19]. If either of these risks comes to life, the financing necessary to complete the project will increase, making it less likely that the future revenues generated by the project will sufficiently cover the debt in full[20] .

[17] Harries, 348-350

[18] Donaldson, 6

[19] Id.

[20] Id.

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Operational risk

This is a more general category of risks, and the precise form of operational risk will depend on the nature of the specific project. These may be materialized after the completion of the constructional phase of the project. The main concern would be whether or not the project is able to successfully produce its end-product (goods or services), which will generate revenue. The risks of the operational phase may include raw material supply, inadequacy of power, water, continuous unavailability of qualified personnel, labor or other technical difficulties[21]. Any of these threaten to result in a situation, where the project fails to produce the expected volumes, doesn't maintain the desired quality, and/or costs significantly more to run [22].

Market risk

Similar to operational risks, the market risk may be materialized after the project is completed and its operation are launched. The market risk is two-sided, as it concerns both the supplies involved with the project and the project sales. The supply risk is crucial if a project is dependent on its ability to purchase raw materials and/or energy at a certain price, for continuous output of its products/ services at sufficiently low costs. The other side of the market risk, equally critical is the project company's ability to its production/services at a competitive price, which can sufficiently cover both the operational costs and the debt service. The fluctuation of prices in both supply and sales markets can significantly affect the debt repayment ability of the project company, depending on the severity of those fluctuations[23]. Fluctuation risks normally cannot be controlled by project companies, unless these are cases of very specific exceptions involving, for example, monopolies.

Political and regulatory risk

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[21] TH Donaldson, 7; Rendell and Niehuss, "International Project Finance, in International Financial Law", (R.Rendell ed., 2nd ed. 1983), 32

[22] Id.

[23] Wood, Project Finance, Subordinated Debt and State Loans, 6; Harries, 349

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Another external risk category, besides the market risk, can be considered can be of political and regulatory nature. The major political risks potentially endangering the project are primarily the expropriation of the project the host country, governmental interference with the project's operations, which can range from import duties, nationalization of the project company's management, excessive changes in laws relating to taxation, war or civil disturbance, which can threaten the construction or operation of the project, a well as blockage of foreign currency remittance, meaning that the funds earned by the project cannot be converted into currency required for the debt service and be transferred outside the country of project's location [24] .

The risk categories discussed are intended to serve as a basis for evaluation of the project lenders' overall credit risk through examining those contractual arrangements which may possibly be influenced by completion, operational, market, political and regulatory risks. These risk categories, while being the most essential ones, obviously, do not represent the whole spectrum of possible project risks. Environmental and social risks, as additional types of risks, may affect the project in certain circumstances.

SECTION III

RISK MANAGEMENT AND LENDER'S SECURITY MEASURES

Risk Identification & Allocation

[24] Rendell and Niehuss, 32; Harries, 349

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The very essence of any project financing is the accurate identification of all risks associated with the project. Without a detailed analysis of these project risks the and, therefore, without a clear understanding of obligations and liabilities that may potentially be assumed in connection with the project, the parties cannot be in a position to consider appropriate timely and efficient risk mitigation tools. Parties need to be make sure that the identified risks are clearly understood and can be managed and monitored effectively. Otherwise, significant expenses can be incurred, along with considerable delays and other possible issues occurred. It should be emphasized that the task of identifying and analyzing risks in any project, however, cannot be left to a single party, and has to involve all the parties, their advisors and other experts to formulate a well-informed risk management plan from all angles.

Inefficient risk sharing pattern is one of the most dominant causes of disputes and issues in project financing, which is why effective risk allocation is a key aspect of crucial importance. It can improve project performances, cut construction durations, significantly reduce incurred costs, improve the quality of completed projects and generally serve as a base for an efficient working mechanism. Some principles should be met to ensure effectiveness of risk allocation between parties involved in the project, which include the following.

A detailed risk analysis should be undertaken at early stages and all possible risk factors and all their variables must be identified and underlined. Firstly, it is crucial to undertake proper risk allocation prior to designing project documentations and contractual packages. Depending on whether parties to the project can control the risk or not, the project finance risks can be divided into controllable internal risks (completion risk) and non-controllable external risks (market and political risks). Most importantly, any particular risk should be, ideally, undertaken by the party which is best able to manage and control the risk under question.[25]

[25] W. Shen-fa and W. Xiao-ping / Procedia Earth and Planetary Science 1 (2009) 1757–1763, 1759; Fred Tinsley and David Eterovic, Project Finance: Australia, 3 International Financial Law Review, Special Supplement, August 1993

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Therefore, for choosing an effective risk minimization method, it should be first estimated, whether the risk is controllable or not, and which party is best suited to control it. The risk management process should not only effectively identify and analyze the possible risks, but also accurately estimate the likelihood of an identified risks being materialized, and then estimate the effects of their materialization, the scope of damage of its effects, to be able to choose the most efficient and cost-effective risk minimization methods.

Efficient risk minimization combats and reduces the probability of occurrence of various developments which may affect a project. In case of external commercial risks, for example, there is little the parties can do to prevent the contingencies coming from general macroeconomic trends or business cycles. Nevertheless, commercial risks arising solely from activities connected with a specific project can be controlled by project lenders, mainly through careful business judgment combined with a variety of safeguard techniques, for example, participation of independent experts in checking the project design and careful selection of contractors according their credit standings.[26] The allocation of risks is carried out through careful and detailed negotiations concerning the whole contractual package of the project and financing agreements.

Lender's Security Measures & Their Application

Security plays an extremely important role in non-recourse project financing, since the lenders will have no recourse other than the project assets, and will be heavily reliant on the cash flow generated by the project to repay the loans. It is, therefore, crucial for lenders to ensure that valid and effective

[26] Stewart E. Rauner, Project Finance: A Risk Spreading Approach to the Commercial Financing of Economic Development, 145 Harvard International Law Journal. Vol. 24 (1983), 161-162

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security tools are used to safeguard their investment in the project. Once the project risks are effectively identified, measured and allocated among the participants, it is time to choose an effective remedy for combatting those risks, should any issues arise, which threaten to hinder the project's success and, thus, profitability and ability to repay its debt. The following includes a non-exhaustive list of methods the lenders can apply for risk minimization in project finance.

Security Over Project Assets & The Importance of SPVs (Special Purpose Vehicles)

In the absence of any shareholder guarantees or other tangible support, enforcing security over the project assets will usually be the only opportunity for the lenders to recover their investments. In most cases where lenders take security over assets which they have financed, they will have to ensure that the assets in question can be sold in a timely manner and with sufficient conditions, to be able to generate enough value to recover the loan amount. In most jurisdictions movable assets will normally not create huge issues for the lenders, although in some jurisdictions this may be an expensive and time-consuming process. Likewise, with most real or immovable property there will usually be a buyer, although the price, naturally, will greatly be dependent on the trends of the local property market, the market conditions, prices and the type of property in question. If the lenders are issuing a loan to a special purpose vehicle and a universal security interest over all the property and assets of the project company is permissible by the host jurisdiction, then this approach is likely to be the most effective. Such security interest takes form of fixed and/or floating charges, with fixed charges being charges over specific assets of a company, usually movable or immovable property owned by the company[27], and the floating charges being a security interest over non-constant or current assets, which can change in value[28]. Current assets are the assets which can be liquidated into cash quickly, and may include current inventory, receivables, current cash assets

[27] Investopedia, Investing, Financial Analysis, Fixed Charge (*What is a Fixed Charge?*), also available at https://www.investopedia.com/terms/f/fixed-charge.asp, last visited 10, May, 2019

[28] Investopedia, Bonds/ Fixed Income (*What is a Floating Charge?*), also available at https://www.investopedia.com/terms/f/floating_charge.asp, last visited 10, May, 2019

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and other easily liquefiable assets[29]. However, it should be noted that while fixed charges are available in most jurisdictions, floating charges are mostly solely available in most common law jurisdictions, and a minority of certain civil law jurisdictions including Finland, Norway, Scotland, Sweden, and Russia [30] .

If the project company is a special purpose vehicle, the lenders will most likely be able to take security over all of its property and assets. Where the project company is not a special purpose vehicle, on the other hand, or in those jurisdictions where global or universal security [31] (charge over all present and future assets of a company) is not recognized, it will be necessary for the lenders and their advisers to identify those assets over which it is possible to take security. In many jurisdictions there will be different ways of taking security and different regulations governing this process, depending on the different classes of assets. For example, security over moveable assets, such as equipment, may require one type of security, whereas security over intangible assets may require a different approach. In most jurisdictions, however, security over land and real or immovable property rights involves the most uniform procedures of all.

Nonetheless, despite general effectiveness behind this approach, because the value of the project assets is primarily determined by the cash generating power of the assets in question, and since “the project lenders are only likely to seek to wind up the project company if something has gone wrong with the project”[32], that is, if there are significant issues with the project, this is unlikely to recover the full amount of the project debt, particularly if the project is incomplete. Selling a half-built tunnel or power station, or any other immovable project asset, is highly likely to be significantly more difficult, if not impossible. It is unlikely to have many interested buyers in such cases, and if the project is situated in a jurisdiction where the consent of government agencies or other public bodies is required, the position may be made even more difficult. It is also highly likely that in such

[29] Investopedia, Investing, Financial Analysis, Current Assets (*What Are Current Assets?*), also available at https://www.investopedia.com/terms/c/currentassets.asp, last visited 10, May, 2019

[30] Philip R Wood, Law and Practice of International Finance: Comparative Law of Security and Guarantees, (1995), 15 and 16.

[31]E. Ferran. Principles of Corporate Finance Law. Oxford: Oxford University Press 2008, 369

[32] Dentons, p 43.

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cases the only potential buyer ends up being the host government, and usually at a fire-sale price, an extremely discounted price, significantly lower than the normal market price for the given property, which most definitely will not be sufficient to cover the project debt[33]. Moreover, in some jurisdictions the sale might not be a directly available remedy for the lenders and might be only be achievable through time-consuming and expensive judicial proceedings.

Additionally, where the project company is not a special purpose vehicle and has other assets apart from the project assets, it is "likely that these assets will have been ring-fenced"[34], fully or partially, that is, will be reserved for a specific purpose, making them unavailable for any other purposes, and/or transferred to an offshore account. Hence, the lender's actions will be limited strictly to enforcing their security solely against the project assets alone. This is normally ensured by putting specific clauses in the loan documentations stating that the lenders are prevented from winding up the project company or taking other equivalent action that would hinder the continued existence of the project company or allow the lenders to pursue the other assets of the project company. However, ring-fencing individual projects may be a useful approach for those lenders who may be want to ensure that projects that they have financed are not allowed to stand as collateral for, or be threatened by, other lenders of the same project company[35]. Therefore, a comprehensive security package will serve as a defensive mechanism designed both to prevent other creditors taking security over the assets or taking other enforcement actions in respect of those assets that they have financed. Naturally, in a scenario where the lenders cannot sell the project assets in question to recover their investment, they certainly would not want any other creditors interfering with those assets in any way. The sole existence of the lenders' security over the project assets, nonetheless, would not be a full proof method of preventing another creditor of the project company, for example, from petitioning to wind up the project company for non-payment of a debt or non-performance of another existing obligation. Therefore, the project lenders have to design the

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[33] Investopedia, Insights, Buzz & Trending, Fire Sale (*What is Fire Sale?*), also available at https://www.investopedia.com/terms/f/firesale.asp, last visited 10, May, 2019

[34] Id.

[35] Id.

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project matters in a way that there are “no other significant creditors outside of the project itself”[36]. And one of the most effective ways to achieve this is to limit the activities of the project company to the project in question. This is one of the main reasons why special purpose vehicles are so useful and important for project financing.

Another question is, which types of assets can the lenders take security on, and what are the specifications for each category. The key project assets over which the lenders can require security will normally include the following:

Plant and Machinery

The significance of plant and machinery will very much vary depending on the nature of the project in question. In a power project, for example, there is likely to be a considerable amount of fixed plant and machinery over which the lenders have to ensure effective security interests. However, it should be noted that the extent to which it will be possible to obtain a non-possessory security, which is a charge or a legal claim over certain assets without their physical possession, over this type of assets varies significantly among jurisdictions[37]. A non-possessory pledge of machinery and/or equipment is possible, and can be registered in France, for example, but only by the person who loaned funds for the purchase of equipment in the first place.[38] In a scenario where the plant and machinery has been supplied by third parties, the title to these assets may be reserved, fully or partially, to the suppliers, normally under retention of title clauses, which stipulate that the title to the goods remains with the seller until the buyer pays the purchase price in full[39]. The main purpose of such clauses is to ensure that, if the buyer goes bankrupt in such scenario where certain goods

[36] Dentons, 44

[37] Investopedia, Investing, Financial Analysis, Non-Possessory Lien (*What is a Non-Possessory Lien?*), also available at https://www.investopedia.com/terms/n/non-possessory-lien.asp, last visited 10, May, 2019

[38] Dentons, 46

[39] Out-Law.com, Supply of goods and services, Commercial, UK, (*Retention of title clauses*), also available at https://www.out-law.com/topics/commercial/supply-of-goods-and-services/retention-of-title-clauses/, last visited 10, May, 2019

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were supplied on credit, and, hence, is unable to pay for them, the seller can repossess the goods in question. Essentially, the seller would have the first claim to such goods & assets, which could prevent the lenders from taking effective security over the assets in question.

Real Property

If the project company owns the land on which the project is built and operated, then this should also be a significant part of the lenders' security. In some variations of BOT projects, such as BLOT, however, the real property is only leased to the project company and it will be a matter of the jurisdiction where the project is situated, whether it is possible to take security over the lease in question. Some jurisdictions also allow separate ownership of the land and the immovable property (building) situated on it, while others do not, which adds an additional layer of variation for such cases.

Bank Accounts

From the lender's perspective, it is also possible to ensure a close control and monitoring of all the project cash flows either through a facility agent or a security trustee. In addition to ensuring that all project revenues flow through specified accounts, the lenders must also ensure that they have a valid security interest over these accounts to be able to effectively control withdrawals and the use of the project cash flows. However, it should be noted that in some civil law jurisdictions, for example, perfecting security over bank accounts is possible solely in those cases where the bank holding the security has control over the account, meaning that it can simply refuse to permit withdrawals from the account in question. To overcome such issues, the project loan documentation should clearly require project revenues to be paid into a jurisdiction where effective security over bank accounts can be obtained, such as United Kingdom or New York, so that the ability of the project company to withdraw funds from these project accounts can be strictly monitored and regulated. [40]

[40] Dentons, 47

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Product

In case of projects, where the output consists of products such as minerals, the lenders may have the option to take security over these products. In most jurisdictions, however, title to minerals is reserved to the host government until they are successfully extracted, which means that no security interest will be possible until the minerals have been extracted. Essentially, the unextracted minerals belong to the state not the private sector, with the companies merely being granted the right to extract these minerals. The ownership is therefore transferred to the companies only upon extraction. So, in a scenario, where the construction of the extraction facility of the project is never completed, taking security over unextracted materials will be impossible.

Other Project Assets

Other relevant project assets over which the lenders may be able to take security over include all the permits, intellectual property rights, which, for instance, may be especially important in certain information technology projects, and contractual rights, such as claims for damages. If universal security is not possible, however, there can often be issues in identifying the extent of such other assets and their values.

Construction Agreements

In BOT projects the construction agreement is one of the key contracts during the construction period, thus, as such form an important part of the lenders' security. Besides taking security over this agreement, the lenders could also seek a direct agreement with the contractor (direct agreements are discussed below). However, if there is no turnkey contractor (a contractor which

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provides a complete package of relevant construction services [41]), then the lenders will likely have to take separate security interests over all or at the very least most essential ones of the construction related agreements along with the security over the project management agreements. This might be a complicated, time consuming and difficult procedure, since if there are separate contractors for different aspects of the construction process, there may be a large room for disputes arising between the different contractors over the scope of their responsibilities and undertakings, which, consequently, might cause delays, and, ultimately, result in the project company being in default under other project documents [42]. To avoid significant gaps in the contractual package of the project and be protected from risks associated with these gaps, turnkey contracts are highly recommended.

Concession Agreements & Licenses

In a BOT project this is another key element of any security structure, since the project company acquires the rights to build, use and operate the project through this document. The very nature of the project's operation normally depends on this concession, which makes such agreements one of the key aspects of the whole contractual package of BOT projects. Therefore, without having effective security over the concession agreement, therefore, the value of security over any property, fixed plant or machinery is likely to be quite limited. A common issue that frequently arises in the process of enforcement of security over concession agreements, however, is the identity of any assignee. In many jurisdictions, local legislation may prohibit foreign entities to own the concession in question (as mentioned above). Even in jurisdiction where this is not the case, it is likely that the right to approve any assignee is reserved for the concession grantor, which can considerably weaken the position of the lenders.

Other Project Agreements

[41] USLegal, Legal Definitions,T,Turnkey Agreement (*Turnkey Agreement Law and Legal Definition*), also available at https://definitions.uslegal.com/t/turnkey-agreement/, last visited 10, May, 2019

[42] Dentons, 46

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For an effective security package, the lenders should also use the option of assigning the benefit of all other project agreements, including supply agreements, operating and maintenance agreements, offtake agreements, and others. For the most important ones among these other agreements, depending on the nature of the project, the lenders also have an option, once again, to require a direct agreement with the counterparty. Ideally, the lenders should aim to take security over all the agreements entered into by the project company in connection with the project. However, in jurisdictions where universal security interest is not available, the lenders may have to limit themselves with the key project agreements alone. Additionally, in many jurisdictions in order to perfect each security interest it is required to issue notices of assignment to the counterparties to such contracts and/or undertake other formalities depending on the specific local regulation, which will significantly complicate and delay this process, especially in projects where there is a large number of project agreements involved, which, in practice, means the vast majority of infrastructural projects [43].

Step-Ins

Step-ins are a tool which provide the secured project lenders with the option to take control of the destiny, that is, to complete the project, and, if possible, operate it after completion, for the purpose generation of the cash flow needed to repay the debt can be available [44].

However, the ability of the lenders to actually use this method greatly depends on the jurisdiction where the project is location. In those jurisdictions, which permit secured lenders to appoint a party to step in and effectively run the project company business as part of the enforcement of lender's security, the lenders should be able to achieve this aim. In most common law jurisdictions this would be possible to some extent, since the secured lenders are given the right, either under the general law or through the specific security documents, to appoint a receiver and a manager over secured assets. Nonetheless, where the relevant local legislation does not recognize and allow for

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[43] Id.

[44] Graham D. Vinter, Project Finance, xxvii (1995), 80; Philip R Wood, Law and Practice of International Finance: Project Finance, Subordinated Debt and State Loans, (1995), 30

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the concept of creditors' representatives taking control of the project assets, this would be nearly impossible or extremely difficult to achieve. This is an issue of many civil law jurisdictions, where the powers of the directors of the project company cannot be displaced by the possessory management of the company through a receiver assigned by lenders. In such circumstances the lenders' only likely protection option would be through the local courts proceedings.

Direct Agreements and Assignment of Rights Through the Project Company's Commercial Contracts

The purpose of a step-in can be indirectly achieved in jurisdictions where it's impossible to achieve directly through direct agreements made between the project lenders and the contractor under the construction contract [45] and other commercial contracts. The purpose of these direct agreement is to enable the project lenders to step in and substitute the project company in the commercial contracts in the event of defaults in its loan obligation [46].

Direct agreement between the project lenders and the parties of the commercial contracts, which include purchasers, suppliers, and other contractors, will usually contains an undertaking from the party of the commercial contract not to exercise any right to terminate the contract under its default clauses, without providing the project lenders a with a prior written notice. The direct agreement between the lenders and the party of the commercial contract can also contain a clause stating that the lenders in turn provides a counter notice to the party's notice, the party of the commercial contract would either permit the project lenders, or an appointed agent by them, to take upon the project company's rights and obligations under the contract for a specified period of time, or give the lender the option to organize the transfer of the contract to a new project company established by the project lenders for this purpose [47]. Through this mechanism the assignment of rights under the commercial agreements of the project company in combination with the direct agreements

[45] See Wood, Project Finance, Subordinated Debt and State Loans, 32; Vinter, 88

[46] Vinter, 88

[47] Vinter, 89

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between the lenders and the parties of the commercial contracts can make the purpose step-ins possible.

Moreover, the overall security arrangement in project financing also normally involves the assignment of rights under long-term supply contracts, such as a “put-or-pay” contract between the project company and suppliers, as well as long-term sales contracts, such as a “take-or-pay” contract between the project company and the purchasers of the project's final products or services to the project lenders. Put-or-pay (or supply-or-pay) contracts are normally provided by suppliers to assure the supply of certain goods or inputs at a set price, for the purpose of meeting the production cost and volume targets [48]. Such agreements essentially put an obligation on the supplier to either deliver a certain amount of inputs or pay for the shortage. Take-or-pay contracts, on the other hand, place an unconditional obligation on the end buyer of the product/ services to either purchase the goods/services at the agreed price in the specified volumes or quantities or to pay the fixed purchase amounts until the contractual period expires[49].

Charge on the Shares of the Project Company or SPV

Another effective and very interesting alternative method of achieving a step-in and taking control over the project’s destiny, which is worth underlining as *an exception*, since it does *not* necessarily fall under the non-recourse scope and focus of this paper, is the option to obtain an equivalent degree of control by taking security over the shares in the project company, if possible [50]. It should be noted, that this method has a certain effect on the nature of financing because the shares of the project company are not the assets of the company itself, but rather, are owned by the shareholders of the project company, be it a special purpose vehicle or not. In this case, since the shares do not remain within the scope of the project assets alone, the security method will not essentially fall

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[48] Peter K Nevitt and Frank Fabozzi, Project Finance, 3 (6th edition, Euromoney Publications.1995), 277; Clifford Chance, Project Finance, (1991), 72

[49] Clifford Chance, 59; Wood, Law and Practice of International Finance, 317

[50] Nevitt and Fabozzi, 52; Clifford Chance, 59; Wood, Project Finance, Subordinated Debt and State Loans, 30; Wood, Law and Practice of International Finance, 323; Vinter, 81

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under "non-recourse" financing, as it will go overboard, by placing charge over assets other than solely the project assets and the project's revenue stream.

The main purpose of this type of security interest is to give the lenders the option of taking over the project indirectly, if significant difficulties, which cannot be solved effectively by the project company effectively, occur, mostly associated with the host jurisdiction regulations on step-ins [51].

It should be noted that the pledging of the project company's shares would mostly be a purely formal type of security, and the purpose of this security is realized quite rarely, since the shares of the project company would hardly have much, if any, market value in case the project company becomes insolvent and fails to perform its contractual obligations. The security also does not give the project lenders any priority right on the project assets ahead of the project company's other creditors, if any[52].

Moreover, whether the taking-over purpose of security is possible to achieve by placing a charge over the project company's shares by the project lenders again greatly depends on the applicable security laws in the jurisdiction of the project's location. The step-in through security of project company shares may only be achievable if the applicable security legislation confers a right of possession to the pledgee, thus allowing the lenders to assume the rights of the shareholders by default under the project loan agreement, making the replacement of the project company's management possible. However, in the jurisdictions where the only the only possibility is the judicial sale of shares, the purpose of step-ins through such type of security may be problematic to achieve. Moreover, in certain jurisdictions lenders, as foreign persons, are not permitted to have security over the shares of a local company, particularly in projects "in the public domain or in strategically important industries"[53]. In this case the only option for the lenders to overcome such restrictions is to ensure that the security over the project shares is reserved to a local bank, which can hold the security on the trust for the lenders, given the local jurisdiction recognizes the concept of trust, which is not universal. It should also be noted, however, that by assuming control through

[51] Nevitt and Fabozzi, 52; Wood, Project Finance, Subordinated Debt and State Loans, 30; Vinter, 81 and 91

[52] Erme, 345.

[53] Dentons, 48.

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the project company's equity in certain jurisdictions, such as the UK, the lenders risk taking on liabilities of the project company by becoming shadow directors of the project company. Shadow directors are majority shareholders, who do not technically and formally direct the company or participate in its governance, however, have their instructions routinely complied with by the company's management. The Companies Act, 2006 of UK defines shadows directors as persons "in accordance with whose directions or instructions the directors of a company are accustomed to act" [54]. Essentially, these are "de facto" directors, and may be held equally liable for the company's obligations, as its de jure directors[55].

Host Government Support

Besides security measures, which can be implemented by the project lenders directly, in some projects, particularly those in developing countries, lenders can also seek an additional layer of security from the host government of the country of the project's location, particularly to combat the political risks associated with the project, while as the remedies discussed above mostly combat the completion and operation risks. This may be a relatively difficult remedy to achieve as many host governments aiming to transfer responsibilities of financing projects to the private sectors might avoid entering into contractual commitments with lenders, especially foreign lenders. Nonetheless, those developing country governments, which aim to attract foreign investment for the purposes of development of certain infrastructure, areas and specific projects they may not have enough allocated resources or experience for, will be likely concerned about their overall "reputation" in the global investment scheme. Effective governmental support and the gestures indicating eagerness and willingness to assist foreign lenders plays a huge role in that reputation, both from the global economic and political point of view, which is why it is likely that the

[54] Legislation.gov.uk The Companies Act, 2006 of UK, 2006 c. 46, Part 10, Chapter 9, (*Section 251)*, also available at https://www.legislation.gov.uk/ukpga/2006/46/section/251, last visited 10, May, 2019

[55] Begbies Traynor Group, Home, Articles, Director Advice, (What is a 'shadow director'? Are they liable in an insolvency procedure?), also available at https://www.begbies-traynorgroup.com/articles/director-advice/what-is-a-shadow-director-are-they-liable-in-an-insolvency-procedure, last visited 10, May, 2019

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governments would be somewhat prone to negotiation, especially if the specific project tackles their interest and promises to build a good "image" for the host government for potential investments in the future.

Whether or not the lenders of the particular project will be able to obtain some sort of support from the host government will also be a matter of the negotiations between the parties involved as well as previous history of successes of failures of similar projects completed in the particular host country. The aspect of obtaining some degree of governmental support from the host country, nonetheless, is especially important, since it's the only way the lenders can somewhat influence political risks associated with the particular project, which, otherwise, are external risks beyond the lenders' control. If such support is successfully obtained, it may include the following:

• An agreement ensuring no change of law which could have materially and essentially affect the project, such as new laws which require changes to certain key specifications of the project in question, for example.

• A guarantee of ensuring the availability of foreign exchange to the project company which will enable to enable the project company to address monetary transfers to the lenders for the repayment of the project debt. If the host country and the lender's country have different currencies, this will be especially important.

• Governmental assurance that no expropriation/nationalization will take place without full compensation, which, at the very list, will include the full repayment of the project debt to the lenders along with other related costs.

• Assurance of maintenance of the general principle non-discrimination approach towards the project and its foreign lenders, concerning taxation and other issues.

• Governmental guarantee that, if the project company complies with all the relevant regulations and its obligations under concession or other appropriate agreement, all necessary consents and

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permits will be granted to the project company for the purposes of successful and compelete operation of the project. [56]

It should be noted that taxation particularly is quite a “sensitive area” [57] in these agreements, along with other the changes in other areas of the host government’s legislation. By this reason most governments simply undertake such constraints on a “non-discriminatory basis”, rather than providing foreign lenders absolute guarantees than no relevant taxation or other laws will change in the future. Simply put, the host governments are more like to simply guarantee that even if changes in legislation do occur, the project company and its lenders will not be discriminated against on an individual basis.

Information and Access to the Project

Another important factor the lenders should consider, as part of the overall remedy package in protecting their funds, is the supply of reliable and accurate information in connection with the project. This also could assume access to the project for the lenders to be able to regularly monitor the progress of the project along with compliance with the terms of the contractual arrangements. The details on the required information and the frequency of its delivery should be clearly stated in the project loan agreement, and would normally include annual accounts and financial statements, periodic progress reports during project construction, copies of material notices and communications received under all relevant project agreements as well as copies of communication between the project company and relevant authorities. These may also include details of all disputes and claims in connection with the project, periodic reports from experts concerning certain aspects

[56] Dentons, 52

[57] Id.

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that might need independent expert monitoring, copies of all insurance documentation, consents and permits relating to the project and its operations, and also certificates of compliance with cover ratios etc.[58]

It should be noted though, that while access to information and the possibility to monitor the project is extremely useful, too much information, especially the type which the lenders do not necessarily need, may be overwhelming for the lenders. As a result, drowning in excessive information the lenders may miss important details in the pool of unnecessary data. By this reason a balanced approach is very important. The lenders should clearly understand and underline the type of information that would be necessary, and this list should be clearly communicated to the project company, to avoid excessive overflow of information, which will not benefit the lender's awareness on the project's progress.

Access to project facilities should also be provided contractually for the independent experts and consultants of the project lenders to be able to visit the project site occasionally for purposes of report preparation. This should not be objectionable by the project company, provided that it receives appropriate notice in advance, and that the experts comply with safety requirements and other reasonable stipulations imposed by the project company in relation to site visits. Confidentiality, however, will usually be an issue and the experts will usually be requested by the project company to sign a confidentiality and non-disclosure agreements.

SECTION IV
ADDITIONAL NOTES

General Problem Areas to Look Out For

In many jurisdictions around the world lenders will encounter difficulties in structuring an effective overall security package to protect the funds invested in project financing. As previously

[58] Dentons, 62-63

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mentioned, these issues usually result when the local security laws either do not recognize the type of security the lenders aim for, or where a particular type of security is possible, local procedural regulation complicate or limit the perfection and the enforcement of such security. Most common problem areas associated with this issues include, but are not limited to the following.

As mentioned above, certain jurisdictions (mostly civil law jurisdictions) do not recognize the concept of trusts, the form of legal relationship where certain property, legal right or security is held by one party for the benefit of another party. This could become an issue in cases where, as mentioned above, lenders, as foreign persons, are not permitted to have security over the shares of a local company, and the sole option would be to reserve such security, for example, to a local bank, which can hold the security on the trust for the lenders. If the local jurisdiction does not recognize the concept of trust, this would be impossible or extremely problematic to achieve for a foreign lender.

Another issue could be encountered by the lenders in such jurisdictions, which impose a total block on creditors enforcing their security during bankruptcy proceedings. In certain jurisdictions lenders may also encounter such issues related to the requirements of any sale of security assets to place through judicial auction procedures. This would be a significant issue for the lenders, as discussed above, due to extremely time-consuming and expensive judicial proceedings.

Governing Law and Jurisdiction

In most internationally syndicated project financings the loan agreements are usually to be governed by either the laws of England or New York, as briefly mentioned above, and there are certain reasons for this. One of the primary reasons the fact that most lenders, such as banks or other financial institutions, when lending internationally, give preference to laws of “an independent country”, such as UK or the USA, to be applied to the lending documents and agreements. This is a simple matter of higher comfort levels associated with the degree of independence offered by the

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laws of a third country. It is also undoubtedly a matter of certain degree of “knowledge and sophistication of the courts” [59] of UK and USA, when dealing with complex international financings.

The position, however, is slightly different with respect to security documents in the project financing contractual packaging. Since the law of security agreements greatly on the nature of the specific security interest type and the location of the asset in question, it is a matter of selecting the appropriate way for taking a security interest over a particular asset in a particular country, rather than a question of the lenders selecting a law of their choice. In this case it is crucial to ensure that the security interest over a land, for example, is valid and effective according to legislation of the jurisdiction of the asset’s location, while laws of other more “sophisticated and experienced” jurisdictions will simply not be relevant.

When it comes to the choice of governing law for other project documents, such as commercial agreements, the parties are generally entitled to select the governing law to apply to that specific commercial agreement. In this case, not surprisingly, lenders on international project financings would also prefer to resort to English or New York law governing all the key project documents. However, the effectiveness and applicability of the choice of law will, again, greatly depend on the nature of the agreement in question. Most concession agreements between a governmental entity and the project company would be governed by the laws of the host country regardless of the choice of law.[60] The room for flexibility in the choice of law for such contracts is available where the parties to the contractual arrangement belong to in different jurisdictions, and therefore there is no compelling governing law. These are the cases where the lenders could be more successful in trying to pursue the application of an independent, such as English or New York, law. Another important notice in regards to these matters concerns the following. In scenarios where the project company is either wholly or partly owned by a government or state entity, the lenders would benefit from

[59] Dentons, 65

[60] Id

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requiring that the project company waives "any right of sovereign immunity"[61] it may have in respect of any legal proceedings against it or any of its assets

CONCLUSION

In project financing arrangements, the contractual package is the main planning and risk allocation instrument, since project financing in general is quite customary, without any universal governing regulations, and thus the role of the contractual package is crucial. In the process of implementation of project with numerous participants, which are dependent on each other, there is a mutual need to ensure that each of the parties in question contributes the project by performing its undertakings, which should be clearly defined through the contractual package. As a risk allocation instrument, the contractual framework project financing distributes risk-related rights and obligations amongst the project's participants, including those in relation to the main categories of risks any project is exposed to, such as completion, operational and market risks, with the addition of other possible risks depending on the type of the project.

Focusing on the security aspects from the project lenders' point of view, it is clear that project financing is a combination of both legal and managerial means and contractual strategies to ensure protection and recovery of the invested funds. The most effective strategies to be used by the lenders for these purposes include, but are not limited to specific securities on different types of project assets, where possible and applicable, strategies that would allow the lenders to take control over the project company in critical situations through step-ins or alternative methods of achieving the purpose of step-ins, depending on the applicable regulations in host jurisdictions, careful selection of governing laws on different types of contracts included in the contractual package, as well as other tools of monitoring the projects conditions, progress and other important indicators.

[61] Dentons, 66

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