need for the lenders to be the direct beneficiaries of the shareholders' promise, which can thus be made to the project company alone.

11.25 Quite apart from the fact that the project company is the natural recipient of the promise of funds from the sponsors, where the equity contribution agreement is governed by English law this approach is also preferable from a technical legal perspective because the project company will be able to establish its claim for damages against a sponsor that fails to make its contribution available in accordance with the requirements of the contribution agreement more readily (and, more importantly, sooner) than a lender would be able to do so. The reason for this is that, unlike the lenders, the project company will have contractual obligations to make payments to third party suppliers in connection with the project works and needs the funding from the sponsors (as well as that from the lenders) to enable it to meet these payment obligations. If, therefore, a shareholder fails to make its contribution available, the project company will be forced[9] either to obtain replacement funds (probably at significantly greater cost) to enable it to make the relevant payments or to default on its own obligations to its suppliers (and so become liable to pay them damages for breach of contract). In either case, however, to the extent the project company is able to demonstrate a causal connection between the shareholder's failure and the costs it has incurred, the project company will probably be able to recover the costs from the shareholder by way of damages for breach of contract.

11.26 If the defaulting shareholder's promise of funding is made to the lenders, then damages are more difficult to establish. What damage does the lender suffer if the shareholder fails to make a loan to the project company? On the face of it, none. The project company may as a result end up in default of an obligation to a third party supplier because he has insufficient funds to pay the supplier, but that is not a loss suffered by the lender. Nor can the lender say his damage is that he himself had to lend the project company the money—he does not have an obligation to lend if the shareholder does not lend and if he elects to do so the amount lent is not (of itself) a loss in respect of which he is entitled to be compensated by the shareholder.[10] Ultimately the lender will only suffer a loss to the extent that the lack of funding can be demonstrated to have resulted in a failure by the project company to repay the lender's loan.[11]

[9] The example is overly simplistic for illustrative purposes. The project company will inevitably have more options open to it in these circumstances.

[10] The lender could, perhaps, procure that a third party make the requisite funds available to the project company, but the damages it would be able to claim from the shareholder if it does so would be limited to the incremental costs charged by the third party (and even then only to the extent they are not reimbursed by the project company). Moreover, a payment by the lender under its guarantee to the third party is akin to the making of a loan by the lender to the project company to enable it to repay the moneys owed to the third party and so would not of itself represent a loss in respect of which he is entitled to be compensated by the shareholder.

[11] This, of course, means that there can be no loss to the lenders unless the project has collapsed. Whilst this may provide the lenders with a degree of comfort, it will in practice be difficult for them

11.27 Whether in these circumstances the lenders would be able to persuade a court to make an order for specific performance requiring the sponsor to make its equity contribution available on the basis that damages for the breach would not be an adequate remedy is debatable. On the face of things, one might well (and in many ways reasonably) conclude that the shortcomings of a mere damages claim (as discussed in paragraph 11.26 above) are clearly such that an order for specific performance would be the more appropriate remedy in these circumstances. However, although it may eventually prove to be the case that this is the correct conclusion, it is in direct conflict with (among other authorities) the decision of the House of Lords in *The South African Territories, Limited v Wallington,*[12] in which Lord Macnaghten observed:

> That specific performance of a contract to lend money cannot be [specifically] enforced is so well established, and obviously so wholesome a rule, that it would be idle to say a word about it. [13]

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to establish that the shareholder's failure to make its equity contribution available was anything other than one of many factors that contributed to the collapse of the project (which means that at best the shareholder will be required to compensate them for only a part of their losses).

[12] [1898] AC 309.

[13] The reason that, notwithstanding the decision in *The South African Territories, Limited v Wallington*, there may be scope for a different conclusion comes in part from s 740 of the Companies Act 2006, which provides: 'A contract with a company to take up and pay for debentures of the company may be enforced by an order for specific performance.' This section (which stems from the Companies Act 1907) reverses *The South African Territories Ltd v Wallington*, but only applies to a contract with a company formed and registered under the Companies Acts (or treated as so formed and registered), with the apparent result that *The South African Territories, Limited v Wallington* still applies to contracts with other companies (and to simple contracts to lend money to companies formed and registered under the Companies Acts). There is some authority for the proposition that in certain circumstances specific performance should be available for an obligation to lend money notwithstanding *The South African Territories, Limited v Wallington* (a) In his dissenting judgment in *Loan Investment Corporation of Australasia v Bonner* [1970] Privy Council 724, Sir Garfield Barwick said (at 742): '*No doubt the general assumption is that damages for breach of a mere promise to lend money adequately compensates the would be borrower. But, in my opinion, that assumption of fact is not necessarily of universal validity and, again in my opinion, must yield in any case when in fact in the particular circumstances damages would not do justice between the parties. So it seems to me that equity in the more complicated situations of the modern world may well yet find an occasion when justice can only be done in relation to a contract merely to lend money by ordering its specific performance*; (b) In *Wight v Haberdan Pty Ltd* [1984] 2 NSWLR 280, the New South Wales Supreme Court (Kearney J) granted an order for specific performance of an obligation to lend money; and (c) In *Lee v Standard Chartered Bank (M) Bhd* [2004] Part 4 Case 15 HMC, the High Court of Malaya (HG Kang J following *Wight v Haberdan Pty Ltd*) also granted an order for specific performance of an obligation to lend money. It is perhaps worth commenting here that, in the same way that a contract to buy a share would not ordinarily be specifically enforceable against the purchaser (because in theory the share could always be sold to someone else), a contract to subscribe for shares will not usually be specifically enforceable. Nor does an obligation to subscribe for shares in a company formed and registered under the Companies Acts fall within the scope of s 740 of the Companies Act 2006. This is because for the purposes of that section debentures are defined (in s 738) to include 'debenture stock, bonds and any other securities of a company, whether or not constituting a charge on the assets of the company', a definition that contemplates only securities evidencing debts and which therefore would not include shares.

Timing of equity contributions

11.28 It used to be the case that lenders could (and would) insist on the sponsors of a project making the whole of their equity contribution to the project company before the lenders would disburse any of their project loans. The logic for this approach was that it was consistent with the proposition that, as between equity investors and lenders (and irrespective of the fact that, as discussed in the Completion Support section below, the sponsors would also be providing completion support), the equity investors should always take the bigger risk (a) because they stand to make the greater return and (b) because (indirectly at least) they are in control of managing the construction and operational risks associated with the project. This logic is sound and is consistent with the accepted proposition that the sponsors should only be entitled to a return on their investment if the project has been completed and is operating at an agreed level of performance (with the result that the project company is discharging its obligations to the lenders in a timely fashion), but things have changed.

11.29 Today, sponsors increasingly make use of equity bridge loan arrangements[14] for the purpose of making their equity contributions to the project company.[15] It is likely that equity bridge loans will be drawn before the senior facilities because they usually have lower margins. However, even in cases where the respective contributions of the sponsors and lenders to the capital costs of a project are made available

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[14] As discussed in Chapter 7, an equity bridge loan is a loan made to the project company under the guarantee of the sponsor on terms such that:

(a) the lender's only recourse with respect to the loan is to the sponsor under the guarantee (i.e. specifically without recourse to the project company and its assets (although equity bridge liabilities are sometimes included in the cash waterfall 'below' liabilities owed to the senior lenders but 'above' distributions to be paid to the shareholders, which means that technically there is recourse to the project company but on a subordinated basis)); and
(b) all claims that the sponsor might have against the project company in relation to amounts paid out under the guarantee (whether the claims arise under a contract of indemnity or by operation of law, thus including rights of subrogation) are subordinated to the claims of the project lenders in the same way as shareholder loans would have been subordinated.

In cases where a sponsor's credit rating does not meet the minimum rating required by the equity bridge lenders, it may still avail itself of the benefits of an equity bridge loan arrangement by procuring that an appropriately rated bank issue a standby letter of credit under which the equity bridge lenders can make drawings if the project company fails to discharge its obligations in relation to the equity bridge loan. This approach will, however, increase the overall cost of the arrangements to the sponsor because it will have to bear the cost of procuring the letter of credit in addition to indirectly bearing the cost of its equity bridge loan.

It is also worth noting that if a sponsor's credit rating drops below an agreed minimum, the equity bridge lenders are likely to require that it procure the issuance of a standby letter of credit by an appropriately rated bank in substitution for the sponsor's guarantee within a specified (and reasonably short) period after the downgrade.

Any 'standby' equity contributions required to be made available by the sponsors will be required to be supported by a guarantee or letter of credit in the same way.

[15] Sponsors generally prefer to use equity bridge loans because doing so improves their return on capital and so enables them to offer more competitive prices when tendering for the project.

pro rata, the equity support and financing documentation will include provisions pursuant to which the lenders will be entitled to require the sponsors to fund their equity contributions in full upon the occurrence of particular events.

11.30 It is now often the case[16] that by using an equity bridge loan a sponsor will not actually fund its equity contributions to a project until a year or two after the project has been completed, although of course the fact that it has guaranteed (or arranged a letter of credit to support) the loan means that its credit exposure to the project is essentially the same as it would have been had it made its equity contribution to the project company in the usual way.

Completion support

11.31 Completion support is simply a label for whatever contractual undertakings are required of the sponsors over the course of the development phase of the project in order to help mitigate completion risk, completion risk essentially being that the project will not be constructed on time on budget and to the required specification:

(1) *On time*: A delay in completion means (in particular) that the project company will have more interest to pay, particularly where delays arise towards the end of the construction period when debt levels are at their highest.
(2) *On budget*: Expenditure which exceeds that contemplated by a project's capital budget (whether because there has been an unexpected need to purchase equipment or materials or because the cost of equipment and materials is simply higher than anticipated) and other unbudgeted expenditure still needs to be funded. It will therefore either give rise to increased interest costs because of the need for additional debt or result in a reduced equity return because of the need for additional equity.
(3) *To specification*: A project which for some reason is not built to specification will be incapable of operating at the level necessary to produce the income that was anticipated it would produce. If the project is less efficient than it should be it will use more feedstock or energy to produce a given quantity of output. If the quality of the output from the project is not as high as it should be it will command a lower price when it is sold. If a project is unreliable and so cannot maintain appropriate levels of production it will both cost more to maintain and be less attractive as a source of supply to purchasers and as a source of revenue to suppliers. Essentially, if a project does not work as intended it will be likely to cost more to run or earn less (or both).

[16] The collapse of Lehman Brothers in September 2008 and its aftermath saw even strong sponsors struggling to put equity bridge loans in place. It took a number of months for lenders to feel sufficiently secure to return to lending to sponsors on the basis of their balance sheets. Even then, the loans available tended to have shorter tenors than they had had in the past and were being made by core 'relationship' banks rather than large syndicates.

11.32 As with other projects risks, it is the potentially damaging financial consequences associated with completion risk that are of particular concern to lenders and sponsors because damage to the project economics will mean (at best) the sponsors will enjoy a reduced financial return on their investment (if not the loss of their investment), which in turn increases the risks faced by the lenders, first, because of the erosion of the financial cushion that the equity provides and, secondly, because a sponsor facing a small or no return on his investment has nothing to provide him with an incentive to do all that he can to ensure that the project will be as successful as it can be in the circumstances.

11.33 As discussed in Chapter 4, project finance is really all about risk and its allocation between the stakeholders involved in the project, with different stakeholders assuming the risks they are best placed to manage, mitigate, or (having regard to the benefits that they will derive from the project) simply accept. The level of support that will be required of the sponsors in any given case will be part of the project's overall risk matrix, the only real rule that can be said to apply in this context being that there is no hard and fast rule that applies: the level of completion support that will be provided by the sponsors of a specific project will depend on the different interests of the different stakeholders.

11.34 At one extreme, there are projects with very high development risks—perhaps because they rely on the use of new (and thus unproven) technological processes—in relation to which the lenders may insist that their loans are unconditionally guaranteed by the sponsors until completion (a requirement that is an anathema to sponsors because it counts against the borrowing capacity reflected by their own balance sheets). At the other extreme are projects where the lenders require that the sponsors commit to do no more than make their agreed equity contributions available to the project company, perhaps coupled with an obligation to use 'reasonable endeavours' to achieve completion within a particular time frame.[17] There are then the projects somewhere in the middle, where the sponsors' completion support might consist of (for example) undertakings to ensure that the project company has the necessary funds to enable it to:

(1) meet all project cost overruns (i.e. costs for which the project company has no other available sources of funds) up to completion;
(2) meet all project cost overruns up to completion on condition that the project lenders make a contribution to the funding thereof as well (which is the effect of the 'standby' equity contributions and loan facilities discussed in footnote 4 above);
(3) meet all incremental interest costs incurred by the project company before completion as a result of delays in achieving completion (and, perhaps, also to

[17] In other words, ultimately without having a substantive obligation to ensure that completion occurs.

meet any scheduled debt repayments that fall due before completion, a less attractive proposition from the sponsors' perspective because undertakings to ensure that principal is repaid begin to look more like guarantees of the debt); and/or

(4) meet the capital cost of making modifications to the project to bring it up to specification in order to avoid price reductions that would otherwise occur or the imposition of penalties (or to fund the payment of 'buy-down' amounts to an off-taker by way of the price for its agreement to a reduction in the project company's contractual obligations with respect to the output from the project so that the guaranteed output matches the actual output capacity of the project), in each case to the extent that there are no other funds available for the purpose.

Completion

11.35 The moment at which the construction phase of a project is completed and the project, whatever it is, is doing whatever it has been developed to do, is one of the most significant milestones in the life of the project, and in many cases is the most significant one because thereafter completion risk is no more (or, perhaps more accurately, is a known quantity). Completion marks the watershed for the project's cashflows, with the replacement of the rapid cash outflow that occurs during the development phase by the rather more modest income stream that, over time, should both discharge the project company's liabilities to its lenders and provide a return to its investors. Going forward, the project's cashflows, whilst still variable, are far more predictable; there are still risks that need to be managed, but by and large once a project is complete both lenders and sponsors can breathe a collective sigh of relief in the knowledge that they have survived the biggest hurdle they faced when they started the project.

11.36 Although self evident, completion will also mark the moment at which any completion support from the sponsors will fall away, leaving the lenders in the position in which (as between the sponsors and the lenders) they will be shouldering more project risk than before.[18]

11.37 The definition of completion in the contracts that regulate the financing and equity support arrangements for a project is therefore of major importance to both lenders and sponsors. It is critical that the definition is as precise as possible and that it deals with everything that each party considers necessary to enable it conclude that the project is complete. The definition, of course, has to be agreed at the time the contracts are signed and although the fact that the interests of the lenders and the

[18] The operation of the cashflow waterfall will leave the sponsors bearing a degree of risk in relation to post completion cashflow problems on a 'first loss' basis because the cash that they are entitled to receive by way of distributions in respect of a given trading period will always be reduced to zero before the amounts payable to the senior lenders will be reduced.

sponsors are in direct conflict in this context (often making negotiations in this area both protracted and acrimonious), it is important from all perspectives to avoid the soft option of including some sort of 'to be agreed at the time' formulation. It is a truism that if it is difficult to agree a definition of what constitutes completion before the relevant contract is signed, it will be virtually impossible to agree the definition when the sponsors have concluded that completion has occurred and the lenders have concluded that it has not.[19]

11.38 The completion definition will involve the project passing a battery of technical tests that measure whatever the engineers conclude it is appropriate to measure for the particular type of project, with details of outputs per input and inputs per output and all manner of other things that lawyers may (or, more likely, may not) fully understand. Some of the tests that will need to be satisfied to establish completion for the purposes of the finance documents will be the same as the tests that establish completion for the purposes of the EPC contract for the project.

11.39 Whether a project passes the various tests will therefore depend in large part on expert technical analysis. Although the tests themselves will be objective (so that it should not matter who conducts them), a frequent commercial issue that needs to be resolved in this context is whether the analysis and resulting technical certification that triggers completion should be that conducted by the technical consultants advising the sponsors or the technical consultants advising the lenders. For the purposes of the EPC contract (i.e. as between the sponsors and the EPC Contractor), it should probably be the sponsors' consultants that confirm completion. For the purposes of the finance documents, however, the fact that, as between the sponsors and the lenders, completion can be said to be disadvantageous to the lenders, there is a good argument to support the proposition that the lenders' technical consultants should be responsible for providing the primary confirmation that completion has occurred, or at least confirming that they agree with the views of the sponsors' consultants. In most instances, therefore, it would be unreasonable for the sponsors not to agree that the lenders' consultant should be required to confirm completion for the purposes of the finance documents, whether independently or in conjunction with the sponsors' consultants.[20]

11.40 It goes without saying that the contracts should provide for all applicable tests to be conducted on a coordinated basis with oversight rights being given to the parties

[19] It is also the case that under English law an agreement to agree an essential term of a contract could mean that in fact there is no contract between the parties at all. (See, for example, *Willis Management (Isle Of Man) Ltd & Willis UK Ltd v Cable & Wireless Plc & Pender Insurance Ltd* [2005] EWCA Civ 806.)

[20] The sponsors would generally protect themselves against an impasse in these circumstances by including in the relevant contracts provisions that allow disputes of this nature to be resolved through some sort of 'expert' determination arrangement rather than by means of the usual dispute resolution process (which would usually involve an arbitration), the idea being that the expert will look at the relevant data and make an independent assessment whether completion has occurred.

that are interested in the outcome of the tests even though they may not be parties to the contracts pursuant to which the tests are being conducted. Completion tests will also usually be used for establishing the level of liquidated damages that are payable under the applicable contract in cases where performance, whilst below the agreed specification level, is not sufficiently far below to cause the project to fail the completion test.[21] The key point to note about the use of completion tests in relation to the release of the sponsors' completion support is that the tests, whatever they are, should be comprehensive and produce a clear positive or negative result in a timely manner.

11.41 In addition to the technical tests that need to be passed to achieve project completion, the financing documents and the equity contribution agreement will include other conditions that must also be satisfied. These will vary from project to project, both as to type and as to scope, but are likely to include:

(1) the requirement that there are then no continuing Events of Default or Potential Events of Default;
(2) the delivery of a set of financial projections for the project prepared on a basis that reflects:
    (a) the actual capital costs incurred in connection with the project (and the mix of debt and equity contributions that have financed those costs); and
    (b) the actual operating capacity of the project as completed (rather than its design capacity, which may or may not have been achieved),

    and that demonstrates compliance with the agreed financial covenants;[22] and

(3) to the extent relevant, evidence that the project company has entered into marketing and transportation arrangements with respect to the production from the project (as well as transportation arrangements for fuel and raw materials) to the extent that these were not concluded at or before the time of financial close.

Post-completion support

11.42 Although it is unlikely that the sponsors of a project will have obligations to make additional equity contributions once completion has occurred, it is normal for

[21] See Chapter 5 for a fuller discussion on how liquidated damages provisions work in this context.

[22] On occasion, there may be negotiations between the sponsors and the lenders as to whether the 'economic' assumptions made at financial close (particularly assumptions as to raw material prices and the price of the product of the project) should be updated for the purposes of the financial tests that must be met in order to achieve completion. The sponsors will maintain that the lenders should take risks of this nature because their due diligence should provide them with sufficient background data to enable them to structure mitigation arrangements that they regard as appropriate in the circumstances.

lenders to require them to seek the lenders' approval to a disposal of their equity interest after completion.

11.43 Shareholding retention covenants do not, of course, oblige the sponsors to do anything other than retain their shares. However, whilst this may be so, lenders can and do take considerable comfort from the sponsors' continued involvement in the project as mere investors. This is because the lenders, quite reasonably, can assume that the sponsors will monitor their investment and, where necessary, take steps to protect it. Those steps may or may not include making further equity contributions, but given that the sponsors (or at least one of them) will have a degree of industry expertise or political connections that are likely to be of benefit to the project company (both in terms of seeing problems that might arise in the future and dealing with problems that may have arisen), there is value in the retention of shares covenants. This reduces over time as the project company develops its own expertise and political connections and its own trading and operating record, which is why the share retention covenants are often (but not invariably) written so that in time they fall away entirely.

11.44 As with the extent of the completion support that the lenders may require from the sponsors, the structure and duration of the 'lock-in' arrangements to which the lenders will wish to subject the sponsors will vary from project to project. It may be, for example, that provision is made for a step-down mechanism whereby the required minimum holding reduces over time or as and when the project achieves further milestones or satisfies more stringent financial ratio tests. However, it is unlikely the sponsors will have unfettered rights to sell their interests in the project until after somewhere between three and five years following completion, and even then the lenders may specify criteria that potential new investors must satisfy before a sponsor is entitled to dispose of its investment. These criteria often include positive requirements such as having appropriate financial standing and technical credentials, but may also include negative requirements such as not being under the direct or indirect control of the public sector entities that control or have interests in the project.

11.45 One of the principal types of post-completion support that sponsors provide in relation to many projects will be the supply of the project's raw materials or fuel or the purchase of the project's output. Indeed, the *raison d'étre* of many projects is to enable a sponsor to sell its products to the project company for some sort of specialized downstream processing or refinement (or to create a captive supplier of a particular product or service that the sponsor requires for purposes connected with one of its own facilities). Where this is the case, of course, the viability of the project (and so the financial health of the project company) is heavily dependent on the continued need of the sponsor to supply the relevant raw materials or fuel (or to purchase the relevant products or services).

11.46 The extent of a project's dependence on the business that the project company will conduct with the sponsors will dictate both the level of interest that the lenders will

have in ensuring that the relevant supply or off-take agreements remain in place and also the strength of any minimum supply or off-take obligations that the sponsors will need to assume thereunder. The more difficult it would be for the project company to set up an alternative supply of raw materials or fuel (or an alternative arrangement for the sale of its products or services) on terms comparable to those offered by the sponsor, the more likely it will be that the lenders will insist on the supply, off-take or throughput contracts with the sponsors (a) remaining in place for as long as the project loans remain outstanding and (b) containing 'supply-or-pay' or 'take-or-pay' obligations discussed in Chapter 5.

Security Arrangements

Introduction

11.47 The contractual arrangements that deal with the creation of security for different project financing transactions are more varied than most other elements of the documentation for different transactions for the simple reason that how security is taken varies from jurisdiction to jurisdiction. There are often similarities (and indeed sometimes striking similarities) between the approaches to the creation of security interests that need to be followed in different jurisdictions. However, even where the principles that apply to the creation and perfection of security interests in different countries are similar (because both countries are 'common law jurisdictions' or 'civil law jurisdictions'), it cannot be assumed that a security arrangement that works in one of the countries will also work in the other.

11.48 It is not just the fact that the project being financed is located in a particular 'foreign' jurisdiction (which to the English lawyer means anywhere outside England and Wales, including in particular jurisdictions such as Scotland and Northern Ireland). Relevant jurisdictions when it comes to taking security can include the countries in which the sponsors (and the SPVs that they may have established for the purpose of holding their interests in the particular project), the Offtakers, Insurers and EPC and O&M Contractors are incorporated and in which the project company's bank accounts are maintained. When this multiplicity of jurisdictions is coupled with the interaction of different legal systems and conflicts of laws principles, issues relating to security and the parties that are granting it can get particularly complicated from the legal perspective.

11.49 Chapter 12 provides an overview of the creation of security interests in civil law jurisdictions which will be of particular interest to lawyers with a common law background and who are generally unfamiliar with civil law principles. This chapter proceeds on the assumption that the reader is either familiar with the English law terminology applicable to the creation of security interests or has access to materials that provide more than sufficient general and specific guidance on the subject.

11.50 Despite the fact that the title of the chapter suggests otherwise, this section does not seek to focus on the documents that will constitute the security under discussion. Nor does it seek to provide an exposition of the types of security that might be included in a typical all-singing, all-dancing debenture granted in a domestic English financing, a definitive explanation of the differences between fixed and floating charges, details of the ins and outs of preferences and transactions at an undervalue, or the distinction between legal and equitable charges and assignments. There are more than enough publications that do all these things and more.

A digression

11.51 Notwithstanding what is said in the preceding paragraph, it is perhaps useful to make a brief mention here of one particularly useful provision that is (and should always be) included in security documents governed by English law. The clause in question is the lowly further assurances clause,[23] a straightforward provision the purpose of which is clear from its terms: it simply obliges the person granting the security to do everything that needs to be done to carry out the basic intent of the security document. It is not a clause that excites many people. It is not a clause that is often negotiated with much in the way of vigour (by any of the parties to the security document or even their lawyers). It is, however, a clause that can create problems for the unwary.

11.52 The pitfall associated with the further assurance clause is more strictly a problem associated with another provision that should also be included in security documents governed by English law, the power of attorney clause, but the two are inextricably linked because it is the power of attorney clause that ensures the further assurance clause is as effective as it can possibly be in all circumstances.

11.53 The power of attorney clause in a security document authorizes the person in whose favour the security is granted to execute any instrument or document which the security provider is obliged, but fails, to execute. The beauty of such a power of attorney clause is that if the power is expressed to be irrevocable and is given to secure a proprietary interest of the donee or an obligation owed to the donee, then (so long as the donee has that interest or that obligation remains undischarged) it will indeed be irrevocable by the donor and will not be revoked by the donor's winding up or dissolution.[24] The sting in the tail in relation to a power of attorney

[23] A typical further assurance clause in a security agreement would read something like: 'The Company shall, at its own expense, promptly execute all such deeds and other documents and otherwise do all such things as the security agent may reasonably require: (a) for the purpose of enabling the security agent to exercise its rights, powers and remedies hereunder, to create, perfect or protect the security hereby intended to be created and to vest title to the Charged Property or any part thereof in the security agent or its nominee(s); and (b) to confer on the security agent security over any property and assets of a Chargor located in any jurisdiction outside England and Wales equivalent or similar to the security intended to be conferred by or pursuant to this Deed.'

[24] Section 4(1) of the Powers of Attorney Act 1971.

is that for a power of attorney to be valid the instrument pursuant to which it is created must be executed as a deed.[25]

Other secured parties

11.54 Contractors, off-takers, major suppliers (such as a fuel supplier), and other project participants (including in some cases the sponsors and their affiliates as providers of mezzanine debt or even junior subordinated debt) may also require that the project company's liabilities to them be secured or that they be given rights to assume responsibility for the operation of the project in specified circumstances. Although ultimately there is no reason why requirements of this nature should not be accommodated, they can only be accommodated if the relevant participants enter into intercreditor arrangements with the senior lenders which identify the circumstances in which the different security interests and other rights held by the various interested parties can be enforced. Such intercreditor arrangements will obviously add another layer of complexity to the financing documentation (and a particularly complicated and contentious layer at that), but should not cause insurmountable problems.

The lenders' approach to security

11.55 The lenders to a project almost always insist on being granted a security package for their loans which is as comprehensive as possible, yet it is surprisingly unusual for them to get to the point where they enforce their security. Moreover, whilst taking and perfecting security over virtually any type of asset (be it tangible or intangible, moveable or immovable, current or fixed, real or personal, present or future, or of some other type) is straightforward, inexpensive, and effective in jurisdictions with a well-developed legal system with experience of catering for complex and innovative financial and commercial transactions, it is often the case that the laws of the jurisdiction in which projects are located are such that, at least in certain respects or as regards certain assets, the security package is of doubtful or limited efficacy or difficult or expensive to enforce.

11.56 It is important, however, not to conclude from this that security is of little real value from the lenders' perspective, particularly in relation to projects in jurisdictions where the accepted view is that the security being granted probably does not work.

11.57 Ordinarily, the security for a project financing will comprise:

(1) security created by the sponsors over their interests in the project company; and
(2) security created by the project company over all its assets.

[25] Section 1(1) of the Powers of Attorney Act 1971.

11.58 We consider a number of points in relation to these two basic categories in paragraphs 11.66–11.69 and 11.70–11.104 below, but before doing that it is worth first answering the following question.

Why take security?

11.59 Although stating the obvious, it is perhaps worth emphasizing that taking security does not provide a creditor with the assurance that the claim thereby secured will be discharged in full; it merely provides him with the assurance that his claim will be paid to the extent of the value of the assets over which the security has been granted (and then only after the payment of all costs he may incur in the enforcement of that security).

11.60 From a legal perspective, the fact that the lenders' claims against the project company are secured means that, when the security becomes 'enforceable' in accordance with its terms (as to which see paragraph 11.62 below), the lenders will be entitled to exercise their rights under the security documents, their ultimate right being to take control of the assets over which the security has been granted and sell them, applying the net proceeds resulting from the sale in the full payment of their claims before any part of such proceeds are available for satisfying the claims of any of the project company's other creditors. In rather more commercial terms, the grant of security for the loans made to finance a project will assure the lenders that, when it matters most (which is to say when the project company is the subject of an insolvency proceeding), their claims are senior to the claims of the project company's unsecured creditors as well as to the claims of its shareholders.

11.61 However, the fact that security gives the project lenders a preferred standing in an insolvency of the project company is not itself the driver for taking security. The real driver is the fact that their security will give the senior lenders the right to control any workout or restructuring that may be needed to survive any difficulties the project has encountered.[26]

11.62 As we have seen in Chapter 7, credit agreements include all manner of provisions designed, essentially, to ensure the success of the project and to enable the lenders to monitor the financial and commercial health of the project so that they have early warnings of problems that could result in their loans not being repaid in accordance with their original amortization schedules. Why then do we need security as well? The answer really lies in the distinction between what is meant by

[26] This is perhaps an overly simplistic statement because it suggests that the claims of other parties can be ignored in a restructuring, which is not the case. It is likely that at least some of the claims of the unsecured creditors to a project will need to be paid in full in order to make a restructuring a success. The most obvious claims that fall into this category are the claims of creditors that supply goods or services to the project which it will be difficult (or more expensive) to source from alternative suppliers.

the enforceability of security, on the one hand, and the enforceability of a contract, on the other. The distinction is important because saying security is 'enforceable' in accordance with the terms of the security document pursuant to which it is constituted is fundamentally different to saying that a contract is enforceable in accordance with its terms:

(1) Security is said to be 'enforceable' if (but only if) (a) a particular state of affairs has arisen and (b) the terms of the relevant security document (or general law[27]) provide that the existence of that state of affairs gives the holder of the security the right to exercise (whether or not under judicial or other official supervision) rights in relation to the property over which he holds security. Where security is enforceable, the rights of the holder of the security will override the rights that the owner of that property may have in relation thereto (subject to the owner's right to redeem his property by discharging the liabilities thereby secured).
(2) A contract, on the other hand, will (assuming the criteria necessary to create a binding contract have been satisfied) be 'enforceable' from the moment it is concluded. (Indeed, if an arrangement that purports to be a contract is for some reason not 'enforceable', it is not properly called a contract at all.) It is thus more accurate to say that a contract is 'effective' rather than 'enforceable'.[28]

11.63 Thus, whilst on its own the credit agreement provides the lenders with the right to demand repayment of their loans (against a back-drop which invariably includes a right as a matter of general law to institute insolvency proceedings if the demand is not met), in the final analysis,[29] the security documents will provide that if the project company fails to perform its obligations and the security becomes enforceable, the lenders will be entitled to seize the project assets to protect their own interests despite the protestations of the project company. Security can therefore be said to be the mechanism that provides the lenders with the most effective sanction underpinning the basic proposition that the rights of lenders in relation to the project should always be 'senior' to the rights of the project company's shareholders (and of the project company's other creditors).

11.64 Notwithstanding that it is the antithesis of security (and as such seems out of place in a chapter dealing with security), it is worth observing here that a negative pledge from a project company (which is to say an undertaking that it will not grant

[27] If a company that has granted security enters a formal insolvency proceeding, it is likely that the creditor will be entitled to enforce his security even if the security document does not specifically so provide.
[28] See also para. 11.127 below.
[29] This is something of an oversimplification because as well as being subject to the debtor's right to redeem his property mentioned in para. 11.62(1) above, a creditor's rights to enforce security may also be subject to constraints imposed by insolvency legislation (which, of course, differ from jurisdiction to jurisdiction).

security over its assets in favour of any other creditors) should not be seen as a substitute for security. A negative pledge in a credit agreement does not, of course, constitute security in favour of the lenders. More to the point, however, it does not prevent the project company from creating security in favour of others. Although negative pledges without security have their place (in credit agreements and bond issues for so-called 'investment grade' borrowers who will (rightly) assume that a breach of the negative pledge is likely to be regarded by lenders as a major breach of trust), they do not make sense in a project financing where their breach could ultimately leave the lenders with nothing more than a valid (but worthless) claim against a shell company that has been lawfully stripped of its assets and revenues by the actions of its secured lenders. The taking of security by the lenders minimizes the risk to the lenders that flow from the breach of a negative pledge and so serves an important defensive purpose that cannot be served by a negative pledge alone. The taking of security by the lenders also makes it more difficult for other creditors who may have overdue claims against the project company to satisfy their claims by seizing the project company's assets, though of course in most jurisdictions it is usually open to creditors with unsatisfied claims to initiate proceedings for insolvency as a means of ensuring that their claims are met (or at least discussed on a sensible basis).

11.65 Security should therefore always be treated as being of critical importance to the lenders' interests in the context of project financing. However, there will always be a need to balance the lenders' preference for obtaining the strongest security possible, on the one hand, with the security that it is practicable to give them in the particular circumstances, on the other. Considerations that might be relevant in relation to this particular debate include, for example:

(1) *The cost of providing the security*: Where mortgage registration fees or stamp duties on a particular security document are linked to the amount of the debt secured by the mortgage, the cost of registering or paying the stamp duty may be so high that to incur the cost would increase the capital cost to the point where the project becomes uneconomic.[30] However, even where the extent of the relevant fees appears to be prohibitive, there can be a logical reason for them to be incurred. Where, for example, the relevant Offtaker is a public sector entity in a particular country, the government of the country might prefer the Offtaker to pay a slightly higher unit price for the whatever the project

[30] A registration fee of $3.50 per $100 is a significant item in the context of a transaction where the fee is calculated by reference to a capital sum of $1,000,000 (the fee being $35,000). Where the capital sum is increased to $1,000,000,000 (which is by no means unheard of) the fee jumps to $35,000,000, which is not the sort of sum that anyone would willingly pay if it could be avoided by the simple expedient of not giving the lenders a mortgage to secure the whole debt. A pragmatic lender is likely to regard a suitably enhanced front end fee or interest rate on his loan (perhaps coupled with the right to insist on the grant of the mortgage in the future in certain circumstances) as an acceptable substitute for a mortgage in these circumstances.

produces over the life of the Offtake contract project in return for the one-off capital payment that will be paid to the authority responsible for collection of the applicable registration fee (probably at the time of financial close).

(2) *The practicality of providing the security*: It may be that security can only be taken over an asset by taking possession of the asset. Even if possession can be achieved by taking control of documents of title rather than the assets themselves, a cost benefit analysis of taking security over (say) stockpiles of oil or coal is likely to lead to the conclusion that the security is better not taken at all, perhaps as long as there are some controls imposed on the level of the stockpiles.

(3) *Contractual limitations that might be relevant to the creation of security interests in favour of lenders*: Although the terms of the financing agreements to which most commercial sponsors are party will probably not restrict the creation of security by a project company in which they have a shareholding interest (or even in their shares in that company), it may be that restrictions imposed on the government in a particular country (notably restrictions such as the World Bank negative pledge) could mean that a government-owned sponsor would need special dispensation before a project company in which it held a significant number of shares could encumber its assets.

Security over the sponsors' interests

11.66 Much of what has been said in the preceding section has been said from the perspective of a lender taking security over the project company's assets. This is the natural perspective in relation to the taking of security because (a) the project company is the borrower of the moneys that the lenders have advanced, (b) the project company's assets actually constitute the project, and (c) the project company's revenues will provide the cashflows needed to repay the loans that the lenders have made. This being so, there is clearly a case for restricting the security package for a project financing to the security that the project company is able to create over its own assets and revenues. However, in most cases, the lenders will seek and receive security over the sponsors' shares in and loans to the project company in addition to the security granted by the project company. There will always be three main reasons for this:

(1) As discussed in paragraph 11.42 above, the lenders will wish to see the sponsors maintain their equity interest in the project. The creation of a security interest in those interests protects the lenders against the risk that a sponsor concludes that the commercial advantages he might gain by selling his interest in breach of his covenant to retain them outweigh the commercial disadvantages (being his liability in damages to the lenders for breach of his covenant) of the breach.[31]

[31] Although a purchaser is unlikely to be particularly keen on buying the shares in circumstances where he knows that the sale is being made in breach of the terms of a contract, he might be prepared to buy them despite the breach if the price is right and he is given a suitable indemnity by the seller.

(2) If the project encounters problems and the lenders find that they have to enforce their security, then having the ability to take control of the project company's shares gives the lenders the ability to take control of the management of the project company (because as shareholders they will be entitled to appoint the project company's board of directors) and so leaves them with greater flexibility in relation to any work-out arrangements that might become necessary.

(3) Again where the lenders find themselves in a position where they have to enforce their security, a sale of the project company's shares is the best way to ensure that the purchaser becomes entitled (albeit only indirectly) to all the project company's rights and interests. More specifically, a sale of the shares in the project company may facilitate the transfer of rights and interests which are not transferable as a matter of law (as is often the case with operating licences and other governmental approvals) or which may only be transferred with the consent of a third party (which may or may not be readily forthcoming, even where the third party has agreed that its consent 'will not be unreasonably withheld or delayed').[32] A sale of shares is also almost invariably quicker, simpler and cheaper than a direct sale of the project company's assets.

11.67 To the extent that a shareholder has agreed to provide financial support to the project by way of a guarantee of the project company's indebtedness to the lenders, there will be a fourth reason for taking security over the shareholders' interests in the project company, and that is that by doing so the lenders' claims under the guarantee will be secured claims in any insolvency of the guarantor.

11.68 It is impossible to even attempt to produce a set of rules that need to be followed with respect to the creation of security over the shareholders' interest in a project company. That said, there are a number of things that should be considered in most, if not all, cases (but always with advice from counsel in all relevant jurisdictions):

(1) What law should govern the applicable security document? It is usually the law of the jurisdiction in which the project company is incorporated because that is usually the *lex situs* of the shares, although the law in some jurisdictions will give effect to a security document expressed to be governed by a foreign law.[33]

He will not, however, be prepared to do so where the shares are the subject of security in favour of the lenders.

[32] It should be noted, however, that a sale of the project company's shares may be indirectly restricted by the terms of 'Change of Control' provisions in contracts to which it is a party or in the licences and governmental authorisations that it needs in order to operate.

[33] Security documents that create charges over the shares of companies incorporated in a number of Commonwealth countries are often expressed to be governed by English law on the advice of counsel in those countries. This is counter-intuitive because an English court considering such a security document would look to the *lex situs* of the shares to determine the effect of the charge. Arguably, it would be better not to have an express choice of law at all because its absence simplifies

(2) What is the effect of the security document as regards the voting rights that attach to the shares? If it operates to transfer title to the shares (as would be the case, for example, where shares in an English company are the subject of a legal mortgage, but not where the mortgage is equitable and not where the shares are only subject to a charge), the voting rights will likewise be transferred. As a result, with a legal mortgage it is necessary to oblige the lenders to vote as directed by the sponsors (at least unless an Event of Default has occurred). It is perhaps worth commenting here that there is often much discussion between lenders and sponsors as to the point at which the lenders rather than the sponsors should control the voting rights in relation to the shares. Although there is no right or wrong on the point, it seems reasonable to provide that votes should be exercisable (a) by the sponsors until the occurrence of an Event of Default, (b) by the sponsors subject to the lenders' approval thereafter unless the security has become enforceable, and (c) by the lenders thereafter.

(3) What is the effect of the security document in relation to future dividends that might be paid on the shares? Again, if the security document transfers title to the shares it will necessarily operate to transfer the dividend rights associated with them, with the result that the lenders should be required to turn over any dividends they may receive to the sponsors.[34]

(4) What should the security document be called?[35] In many jurisdictions security over shares is created by means of pledge, and for some reason it is this terminology that is most widely used (and understood) to refer to the charging instrument that creates security over shares whatever the applicable governing law. This notwithstanding as a matter of English law it is technically incorrect to describe shares as being 'pledged' pursuant to 'pledge' agreements because a pledge involves the bailment of a chattel as security (and a share in a company—even a bearer share—is not a chattel).

(5) Will liabilities attributable to the shares be transferred to the lenders when the security is created (thereby, for example, making the lenders liable to pay the balance of the moneys due in respect of any partially paid shares)? Ordinarily one would expect that liabilities attaching to shares would only be transferred where legal title to the shares is transferred upon creation of a security interest. Whilst this may be so, the analysis needs to go further. It is quite possible, for example, that there will be provisions in the project company's constitutive

the analysis. New York law is also often expressed as the governing law of security packages relating to Latin American projects which often leads to expensive and cumbersome perfection requirements.

[34] The terms of the credit agreement or common terms agreement with the project company will invariably specify the conditions that must be satisfied before the project company is permitted to pay dividends. If the specified conditions have been satisfied, dividends paid to the lenders because they are the legal owners of the shares would therefore always be required to be paid over to the sponsors.

[35] This question is not a particularly important one because it will be the operative provisions in the document, rather than its title, that will determine its effect.

documents that allow it to refuse to recognize a transfer of a partially paid share (whether or not the project company has made a call on the share). Even if this is not the case, a sale of the shares upon an enforcement of the security would necessarily involve a transfer of the liability for future calls, which will inevitably make the shares less attractive to potential purchasers. (The answer of course is for the lenders to insist that the shares be fully paid before they take security.)

(6) Should the shareholder deliver the originals of his share certificates to the lenders at the time the security is created? If the project company is incorporated in a jurisdiction in which share certificates evidence title to the relevant shares, counsel in that jurisdiction will almost certainly advise that the share certificates should be entrusted to the lenders (or a custodian acting on their behalf) as part of the process of perfecting the lenders' security interest. Even in jurisdictions (such as England) where share certificates are not evidence of title, it is likely that (unless title to the shares has been transferred to the lenders or someone acting on their behalf) counsel will make this recommendation, but in these jurisdictions it will not be to perfect the lenders' security interest so much as to make it more difficult (but not impossible) for the shareholder to deal with his shares in breach of his covenants in the finance documents.

(7) Should the shareholder provide the lenders with share transfer forms executed in blank when the security is created? Charges and equitable mortgages of shares governed by English law ordinarily include provisions that entitle the chargee or mortgagee to 'upgrade' his security interest in the relevant shares by converting it into a legal mortgage. Coupled with a power of attorney in his favour, this will give him the necessary authority to do whatever needs to be done to register the shares in his own name or the name of his nominee. Where this is the case, blank stock transfer forms do not need to be delivered at the time the security is created.

11.69 Even where a security document pursuant to which a sponsor creates security over its shares in the project company constitutes security over any dividends and voting rights attributable to them, it will not (without more) create security over the sponsor's interest in any shareholder loans that may be outstanding from time to time. Shareholder loans are an integral part of the sponsor's commercial interest in the project and as such (and for the same reasons that the shares are made the subject of security in favour of the lenders) should be charged in favour of the lenders pursuant to appropriate security documentation.

Security over the project company's assets

11.70 This section considers the types of security that a project company will typically grant over its assets to secure the loans from the senior lenders. Although the actual security that will be granted in any given case will depend on the nature of the particular project and the assets concerned (from an English law perspective the

lex situs of a tangible asset being of fundamental importance in the determination of the efficacy of any security over the asset), most project financings will involve security over:

(1) the principal physical assets that constitute the project (i.e. the project site and the buildings that house the items of plant and equipment that produce whatever the project produces);
(2) stockpiles of raw materials and fuel, spare parts, and other items of inventory such as unsold production from the project;
(3) the project company's rights under the contracts to which it is a party (notably the contract pursuant to which the project is being constructed, any supply contracts for fuel and raw materials, any off-take contracts pursuant to which the project's output is sold, operation and maintenance contracts, and marketing agreements) as well as under any applicable operating licences and permits and the like (to the extent applicable law permits them to be made the subject of security);
(4) the project company's intellectual property rights (in particular any licences that it may have been granted for the purpose of using particular manufacturing processes in the project);
(5) cash from time to time held by the project company in its bank accounts, as well as cash equivalent investments that the lenders may have agreed it may hold in order to generate a better return than it would earn on simple cash deposits; and
(6) any claims the project company may have under the policies of insurance that it maintains in connection with the project.

11.71 English law (like the law of many other jurisdictions, both civil and common law based) looks to the *lex situs* of tangible assets in order to determine how (as a legal matter) security over the asset should be created (because it is the *lex situs* that determines the applicable rules as to title to the asset and its transfer). However:

> The choice of law rules which govern the assignment or transfer of intangible property are not easy to state with certainty . . . It is unrealistic for a single choice of law rule to govern all issues relating to the assignment of all such property.[36]

This being so, it is therefore not possible to do more than make general observations in relation to the sort of security interests that are created over the various types of asset described in paragraph 11.70 above. However, it is worth observing that even in cases where a project is located in a jurisdiction having a legal system which is less sophisticated than that of, say, England or some other Western European country, many of the project company's assets will not in fact be located in, or otherwise subject to the laws of, the jurisdiction in which the project itself is situated. As a result, even though some of the security that the lenders may require might be of

[36] *Dicey, Morris & Collins The Conflict of Laws* (14th edn) para. 24-051.

limited or doubtful efficacy, much of the security package will be as good as it would be if the project was located in a jurisdiction with a more developed legal system. Thus with an oil refinery project in Yemen, any security over the refinery and the site on which it is located may well not be as effective as comparable security over a refinery in Germany, but security over the project company's offshore bank accounts and offshore insurances, as well as the security over its rights under sales and other contracts with parties outside Yemen, will not be limited by the fact that the project is in Yemen.

11.72 The primary question to be answered in relation to the creation of security over a tangible asset is therefore: 'Where is the asset that is to be made the subject of the security located?' The same question may also become relevant in relation to the creation of security over an intangible asset, but in that context the answer is more complicated because its 'location' will be derived from legal rules and the application of these rules often result in the asset being 'located' in more than one place at the same time.

11.73 Deciding on the location of land and buildings is straightforward. Deciding on the location of items of moveable property such as trucks, trains, and aircraft is also straightforward but the fact that such items of property can be in one jurisdiction one minute and in another jurisdiction moments later can have surprising consequences, as is apparent from the recent decision of the High Court (Beatson J) in *Blue Sky One Limited v Mahan Air*,[37] in which the court considered the validity of a mortgage expressed to be governed by English law over an aircraft that was registered in England. At the time the mortgage was created, the aircraft was physically located in the Netherlands. Had the aircraft been in England at the time the mortgage was created, it would have been valid. However, because the *lex situs* of the aircraft at the time of creation of the mortgage was the Netherlands, the validity of the mortgage was (as a matter of English law) a question that fell to be determined as a matter of Dutch law. Under domestic Dutch law the mortgage was invalid. However, under Dutch conflicts of laws rules the mortgage would have been treated as valid if it was valid under the law of the jurisdiction in which the aircraft was registered (i.e. England). The English court's conclusion? The mortgage was invalid because in applying Dutch law to determine the issue of the validity of the mortgage the English courts should apply only Dutch domestic law without reference to its conflicts of law rules (and in particular taking no account of the principle of *renvoi* whereby Dutch law would determine an issue by reference to some other system of law). (Whether this decision, which was not welcomed by aircraft financiers, will be overturned on appeal remains to be seen.)

[37] [2010] EWHC 631 (Comm).

Land and buildings/plant and equipment

11.74 Whatever security can or cannot be taken over the site on which the project is located and the buildings, plant, and machinery on the site will be a matter of the law of the country in which the project is located. Although most of the more general questions that it is important to consider in this context are reasonably obvious (and will be asked as part of the general due diligence exercise in relation to the whole project), it is perhaps worth noting a few of them here:

(1) Does the security over the site automatically include the buildings and the plant and equipment that will be built on site or moved to the site having been built elsewhere? In some jurisdictions[38] it is not possible to take security on an asset until the asset exists. In such cases, the financing arrangements may be structured so that the lenders' security is only put in place at the time of Project Completion (perhaps on the basis that until then the loans to the project company will be guaranteed by the sponsors).[39]
(2) Does the security include all rights of access and easements that the project will need in order to operate? If the security is ever to be enforced, a potential purchaser of the project would be more than a little troubled if in buying the site he was not also buying all rights that will enable him to cross adjoining properties in order to get all his fuel, power, and raw materials to the plant (and to remove all his production and waste materials from it).
(3) Does the project company own the site outright or does it simply have an entitlement to occupy it under a lease, and if the latter:

    (a) In what circumstances does the lessor have the right to terminate the lease?
    (b) Are the lessee's rights under the lease freely transferable?
    (c) Is the lease term longer (by some margin) than the economic life of the plant that is being built on the site?
    (d) Will the plant need to be decommissioned and dismantled when the lease term comes to an end so that the site can be returned in the state it was in when the lease was granted?

(4) Does the security over the site include (for example) stockpiles of fuel and raw materials or of the output from the plant? If not, can these items of inventory be made the subject of a security interest? The English answer to the creation of security over stockpiles and inventory is the floating charge, a somewhat mysterious (and some would say remarkable) creature of English common law which allows a creditor to be granted security over a class of assets owned by a company

[38] For example, Norway and Brazil.

[39] It may be that security could be taken over moveable assets—such as earth-moving and transportation equipment used in a mining project—in the jurisdiction in which that equipment is manufactured. The question will then become one of the efficacy of the security in the jurisdiction in which the project is located. However, even if such security is effective in the local jurisdiction, this sort of solution is only likely to be practicable where the particular assets have a relatively high unit value.

from time to time on terms which, until the moment at which the charge 'crystallizes' (and thereby becomes a fixed charge on such of the assets within the relevant class as are then owned by the company), allow the project company to sell the assets free and clear of the creditor's interest without the need for the consent of, or even the giving of notice to, the creditor. However, despite its flexibility, a floating charge governed by English law will still look to the *lex situs* of the relevant assets to determine whether the charge is effective.[40]

Contract rights

11.75 The security package for any project financing will invariably include assignments by the project company of the benefit of all the contracts which it has entered into in connection with the project. Indeed, until the project is complete and the project company is the proud owner of a brand new, state of the art plant for doing whatever the project does, the project company will in reality own nothing much else over which it can grant security for the debt that it is incurring.

11.76 The actual assignment of the relevant contract rights is unlikely to be anything other than straightforward, although it is worth bearing in mind that rights under some contracts may not be assignable as a matter of law.[41] It is also worth bearing in

[40] Security documents in relation to project financings in jurisdictions where the effectiveness of the security agreements governed by local law is uncertain sometimes include a charging instrument governed by English law pursuant to which, in addition to granting fixed security interests over its offshore assets, the chargor grants a floating charge over all its other assets, wherever situated (and therefore including its assets in its home jurisdiction). Given the fact that, at least as regards tangible assets, English law looks to the *lex situs* of the assets to decide whether the security is effective, it is difficult to see how this approach can actually achieve anything more than a security agreement governed by the law of the local jurisdiction.

[41] Government licences and permits required for the operation of a project are often incapable of assignment except with the approval of the authority that granted the relevant licence; sometimes the applicable enabling legislation will not even allow assignments with an approval. Whilst this may appear to be a potential problem that can arise in the course of the process of producing the financing documents for the project, these sorts of assignability issues should come to light in the course of the initial due diligence exercise for the project, with the result that appropriate mitigation provisions will be built into the contractual structure in some way. The point is noted here more for the sake of completeness. As a general rule the benefit of a contract governed by English law will be assignable as long as 'it can make no difference to the person on whom the obligation lies to which of two persons he is to discharge it'. (*Tolhurst v Associated Portland Cement Manufacturers Ltd* [1902] 2 KB 660 at 668; affirmed [1903] AC 414). The question is an objective one, but the court would not, for example, distinguish between persons on the basis that they would probably have differing attitudes towards defaulting debtors (*Fitzroy v Cave* [1905] 2 KB 264). Contractual rights that involve personal qualifications or skills of the creditor are not assignable, so even though an author can assign his right to be paid royalties under a publishing contract, neither the publisher nor the author may assign his rights to the other's performance under the contract (*Stevens v Benning* (1855) 6 De GM & G 223; *Hole v Bradbury* (1879) 12 Ch D 886; *Griffiths v Tower Publishing Co* [1897] 1 Ch 21; *Don King Productions Inc. v Warren* [2000] Ch 291).

It is assumed that where a particular project agreement includes restrictions on the assignment by the project company of its rights thereunder the restrictions will make a specific exception for the assignment of the agreement to the security agent in connection with the financing arrangements. Restrictions on onward assignments by the security agent should it have to enforce its rights under

mind whilst the assignment itself might be straightforward enough, complications inevitably arise when the time comes to negotiate the terms of the related direct agreements (as to which see paragraphs 11.105–11.114 below).

11.77 As with tangible property, an important preliminary question that will need to be considered in the context of creating security over contractual rights is the governing law that should be chosen to govern the contract pursuant to which the assignment is effected (the 'assignment agreement').

11.78 More specifically, does the governing law chosen to govern the assignment agreement need to be the same as the governing law of the contract being assigned (the 'assigned contract')? In relation to contracts signed on or after 17 December 2009, the answer to this question as a matter of English law (and the law of the other states in the EU other than Denmark) is provided by Article 14 of Regulation 593/2008EC on the law applicable to contractual obligations (Rome I) and is surprisingly simple. The effect of Article 14 (coupled with the other provisions of the Regulation) is essentially[42] that:

(1) the parties' choice of the governing law of the assignment agreement will be effective; and
(2) the law so chosen need not be the same as the governing law of the assigned contract (because, under Article 14(2), whatever the governing law of the assignment agreement, the governing law of the assigned contract will 'determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment . . . can be invoked against the debtor and whether the debtor's obligations have been discharged').

11.79 Although on the basis of Article 14 of Rome I there is no reason not to use English law as the governing law of the assignment agreement relating to contracts governed by (say) the laws of the Sultanate of Oman, in many (and probably most) cross-border financing transactions where some of the project documents are governed by the law of the jurisdiction in which the project is located ('local law')

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the relevant security document will be dealt with in the relevant direct agreement, as discussed in para. 11.112 below.

[42] There are exceptions to the general rule. Articles 3(3) and 3(4) of Article 3 of Rome I provide: '3. Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement. 4. Where all other elements relevant to the situation at the time of the choice are located in one or more Member States, the parties' choice of applicable law other than that of a Member State shall not prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement.'

Article 9 of Rome I makes provision whereby Rome I can be overridden by 'mandatory overriding provisions' of (a) the law of the forum in which a dispute on a contract is being conducted and (b) of the country where the obligations arising out of a contract are to be or have been performed (insofar as those overriding provisions render performance of the contract unlawful), mandatory overriding provisions being essentially matters of public policy.

while others are governed by English law (or the law of some other jurisdiction), the practice has been (and continues to be) to use the governing law of the assigned contract as the governing law of the assignment agreement. Thus:

(1) the benefit of the project agreements governed by local law will be assigned pursuant to an 'onshore' security assignment (i.e. an assignment agreement governed by local law);
(2) the benefit of any project agreement governed by English law will be assigned pursuant to the main 'offshore' security document (which will be governed by English law); and
(3) the benefit of any project agreement governed by the law of some other jurisdiction will be assigned pursuant to an assignment agreement expressed to be governed by the law of that other jurisdiction.

11.80 There is one very good reason why this approach should continue to be adopted: if it ever becomes necessary to institute any legal proceedings in connection with the lenders' security interest in the relevant project agreements in the local law jurisdiction, having both the assignment agreement and the assigned contract governed by local law means that the proceedings should be simpler (and in consequence both quicker and cheaper) because there will be no need to complicate matters by reference to the conflicts of law rules that apply in that jurisdiction.

11.81 Generally speaking, from the moment at which a party to a contract assigns 'all its rights' under that contract to another, as between the assignee and the assignor the assignee will be entitled to exercise all those rights. In the same way, once a party to a contract has (a) assigned 'all its rights' thereunder and (b) given notice of such assignment to the relevant counterparty, as between the assignee, the counterparty, and the assignor, the assignee will be entitled to exercise those rights to the exclusion of the assignor. Two straightforward, but critical, points arise from this in the context of a security assignment:

(1) In order to ensure that the assignment by the project company to the security agent is effective as between all relevant parties, notice of the assignment will need to be given to the relevant counterparty.
(2) In almost every case it will be necessary to include provisions in the assignment agreement (and corresponding provisions in the notice of assignment) that allow the project company to continue to exercise some or all of its rights under the contract as if the assignment had not occurred (and so without reference to the security agent) until something happens (the 'something' invariably being linked in some way to the occurrence of an Event of Default)[43] which makes it appropriate to curtail the project company's authority.

[43] Whether the project company's rights should be terminated sooner rather than later will depend on the circumstances and the negotiations between the parties. From a practical perspective, however, using the concept of a 'Declared Default' to define the time at which the project company ceases to

11.82 The particular rights that the project company will be permitted to exercise as if the assignment had not occurred will vary from project to project, though it would be more than a little surprising if a project company was permitted to amend (at least in a material way) or terminate any of the key project contracts without reference to the lenders. To some extent, the rights that the project company will be left free to exercise will also vary with the type of contract being assigned, primarily because some contracts require the project company to perform a more active monitoring role than others. An assignment agreement relating to an EPC Contract, for example, will need to give the project company extensive rights to continue to exercise the rights thereunder subject to a specific list of 'reserved discretions' (which the project company is not entitled to exercise without the consent of the security agent) because this ensures that the lenders only get involved where a particular decision could be expected to affect the security value of the contract. The flexibility that will be given to the project company in relation to an EPC Contract will not generally be mirrored in an assignment agreement relating to an Offtake Contract (except perhaps as it relates to purely operational matters such as shipping and delivery schedules), the general rule here being that most decisions affecting the Offtaker's performance thereunder will be decisions with which the lenders will wish to be involved.

Receivables, bank accounts, and permitted investments

Receivables

11.83 An assignment by the project company to the security agent of its rights under a project agreement will necessarily include its rights to receive moneys paid under that agreement.[44] In the absence of an instruction to the contrary, therefore, once notice of the assignment has been given to the relevant counterparty, amounts payable by the counterparty thereunder will be required to be paid to the security agent. This is perfectly logical, not least because once an amount payable under a contract has been paid in accordance with the requirements of the contract, the security value of the contract is necessarily diminished by that amount: the fact that the security value of the contract is diminished is of no consequence if the arrangements are such that the security agent comes into possession of a cash fund (in the

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be entitled to exercise any of the rights under the contract produces a sensible compromise between the interests of the lenders and the interests of the project company. There is no real need to change the *status quo* simply because an Event of Default has occurred (though it might be, for example, that whilst an Event of Default subsists the project company should be required to give a minimum period of notice to the security agent of its intention to exercise particular rights in order to give the security agent an opportunity to object to the action). On the other hand, leaving the project company free to continue without the imposition of some level of additional control by the lenders until the point at which the security becomes enforceable is in reality leaving it too late.

See also the discussion in para. 11.85 below.

[44] The discussion in para 11.78 above applies to receivables payable under a contract as it does to other rights under the contract.

form of the credit balance on its bank account) which replaces the receivable under the contract. However, whilst this may be logical because it preserves the lenders' security position, it does not produce a practical result because it means that the money is inaccessible to the project company except to the extent the security agent actually takes steps to transfer the money from its account to the project company's account.

11.84 In order to give the project company access to the funds paid under the project agreements that it will need for its day to day operations and at the same time preserve the lenders' security position in relation to the project revenues, the normal practice is for:

(1) the notices of assignment that are given to the counterparties to the various project agreements to stipulate that, notwithstanding the assignment thereof:

   (a) unless the security agent otherwise directs, moneys of a revenue nature[45] payable to the project company thereunder should be paid by credit to a specified account in the name of the project company;[46] and
   (b) moneys of a capital nature payable to the project company thereunder should be paid by credit to a specified account in the name of the security agent; and

(2) the account in the name of the project company referred to in sub-paragraph (1)(a) above to be charged in favour of the security agent as part of the general security package for the financing.[47]

11.85 In the same way that the project company will normally be expressly authorized to exercise its rights under an assigned project agreement until something happens that makes it appropriate to limit its authority in this respect,[48] the Security

[45] The notice of assignment should not, of course, simply refer to 'moneys of a revenue nature' or 'moneys of a capital nature'. It should specify which particular payment obligations fall into which category by reference to the particular clauses under which those obligations arise.

[46] The moneys could be paid into the account of the security agent who could then set up a standing instruction on the account requiring that all moneys paid into the account are automatically transferred to the project company (or give the project company signing authority on the account (exercisable as agent for the security agent)) and therefore the right to withdraw moneys therefrom without reference to the security agent. However, this sort of approach rather obscures what is actually happening and so has the potential disadvantage of leaving it open to interested parties (notably a liquidator of the project company) to argue that the project company has some sort of interest in the security agent's account (but without necessarily being effective to avoid the problems of control associated with *Spectrum Plus* (as to which see paras. 11.91–11.95 below)).

[47] The creation of security over the project company's bank accounts is complementary to the detailed account management provisions which will be included in the principal financing documentation in order to specify the bank accounts to which the project company's different sources of income must be credited and then to regulate the expenditure that may be funded with the moneys in the different accounts (an exercise which is primarily intended to simplify the process of monitoring the financial health of the project).

[48] See para. 11.81 above.

Document pursuant to which moneys payable to the project company are assigned will usually allow the security agent to direct the counterparty to make payments direct to the security agent at any time after the occurrence of an Event of Default (or perhaps a Declared Default). A point to note in this context is that it is preferable (from the perspective of both the lenders and the counterparty)[49] for the notice of assignment not to state that the security agent is only entitled to give contrary instructions regarding the payment of money if a default, Event of Default, or Declared Default has occurred or similar circumstance arisen. This is because to do so exposes the security agent to the risk that when it gives the contrary instructions the counterparty will want some evidence of the occurrence of the relevant event before it will make payments in accordance with the new directions for fear that if in fact the event has not occurred, it could be compelled to pay an amount to the project company that it had already (but wrongly) paid to the security agent.[50]

Bank accounts

11.86 A bank account is nothing more than a means of recording the extent of a bank's liability to its customer (in which case the account will be in credit and the customer will have an asset in an amount equal to the amount of the debt constituted by the credit balance) or the liability of a customer to its bank (in which case the account will be in debit and the bank will have an asset in an amount equal to the debt constituted by the amount of the debit balance). Creating a security interest over the project company's money in any of its bank accounts therefore involves creating a security interest in its claim against the bank with whom the account is maintained. This being so, Article 14 of Regulation 593/2008EC on the law applicable to contractual obligations (Rome I)[51] applies to the creation of security interests in relation to bank accounts as it does to other contractual claims.

11.87 It is reasonable to assume that if the terms and conditions that apply to the relationship between a bank and its customer in relation to a bank account specify that their respective rights and obligations are governed by the law of a particular jurisdiction, the jurisdiction specified will be that in which the branch of the bank at which the

[49] From the point of view of the project company, the position should be regarded as neutral. If the terms of its contract with the security agent stipulate that the security agent can only give a notice in certain circumstances but it gives the notice notwithstanding that those circumstances have not arisen, the project company has a claim for breach of contract against the security agent. There is no justification for the project company insisting on more than this, particularly as anything more could in practice be used by the counterparty to the contract in a way that could operate to the detriment of the lenders.

[50] There is also the risk that the security agent may be unwilling to write a letter to the counterparty stating that an Event of Default has occurred without suitable indemnification from the lenders. Even if the indemnification is forthcoming, it will not be forthcoming very quickly, with the result that the relevant moneys will not necessarily be paid to the security agent in the circumstances in which, as a commercial matter, it has been agreed that the project company should not be receiving them.

[51] See para 11.78 above.

account is maintained is located.[52] It is probably also reasonable to assume that, if the terms and conditions that apply to the relationship between a bank and its customer in relation to a bank account do not specify that their respective rights and obligations are governed by the law of a particular jurisdiction, then under the law of the jurisdiction in which the branch of the bank at which the account is maintained is located (and the law of most other jurisdictions to the extent they may be relevant), the governing law applicable to those rights and obligations will be that of the jurisdiction in which the branch of the bank at which the account is maintained is located.[53]

11.88 It is likely that there will be bank accounts located both in the jurisdiction in which the project itself is located and, where the financing arrangements are governed by English law, in England. As a result, the bank accounts in England will certainly be charged pursuant to a security document governed by English law but (as was the case with contracts governed by the law of the jurisdiction in which the project is located)[54] the onshore bank accounts (which is to say those in the jurisdiction in which the project is located) will usually be charged pursuant to a security document governed by the law of that jurisdiction.

Problem areas

11.89 There are two principal issues in relation to the creation of security over bank accounts in England. The first of these (which is also an issue when it comes to creating security over receivables) is whether the charge is fixed or floating. The second is whether the charge falls within the ambit of the EU Directive on Financial Collateral Arrangements (Directive 2002/47/EC).

11.90 There is also a related issue which is not so much a question of the efficacy of security in relation to bank accounts as a question as to how best to deal with 'permitted investments' in a way that protects the lenders' security position and at the same time gives the project company (and indirectly the sponsors) a reasonable opportunity to earn a better return on funds that are surplus to the project's immediate cash needs than can be earned by maintaining them as simple cash deposits with the

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[52] Certainly it would unusual if the terms and conditions were to specify that the laws of some other jurisdiction should regulate these rights and obligations.

[53] This would be the position throughout the EU other than Denmark on the basis of the rules in Article 4 of Regulation 593/2008EC on the law applicable to contractual obligations (Rome I). Article 4(2)–(4) provides:

(2) . . . the contract shall be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence.

(3) Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs or 2, the law of that country shall apply.

(4) Where the law applicable cannot be determined pursuant to paragraphs 1 or 2, the contract shall be governed by the law of the country with which it is most closely connected.

[54] See the discussion in para. 11.79 above.

account bank for the project. Both the issue of whether a charge will be characterized as fixed or floating and the issue of whether the EU Directive on Financial Collateral Arrangements (Directive 2002/47/EC) will apply to such a charge are relevant in the context of charges on permitted investments.

Fixed or floating?

11.91 In his judgment in *National Westminster Bank plc v Spectrum Plus Ltd*,[55] Lord Scott of Foscote described the essential characteristic of a floating charge to be:

> . . . the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime the chargor is left free to use the charged asset and to remove it from the security.[56]

11.92 On the basis of this definition, any arrangement that allows a chargor to deal with its book debts or their proceeds[57] (or amounts equal thereto) will necessarily mean that a charge over those book debts is a floating charge. To create a fixed charge, the holder of the charge must actually (and actively) control the process of releasing funds to the chargor.

11.93 The test is reasonably clear: are the arrangements so structured that the book debts (and their proceeds) are appropriated to the charge holder's security, or is the chargor permitted to deal with them and so use the proceeds as a source of cashflow (whether the permission be until further notice or the occurrence of an Event of Default or for a limited period of time)? In the former case, the charge will be fixed, whilst in the latter it will be it will be floating.[58]

11.94 In practice, the extent of the rights that are normally retained by a project company in relation to its receivables and the credit balances on its bank accounts is such that it is difficult to see that a charge on these assets will be anything other than floating.

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[55] [2005] UKHL 41.

[56] At 111.

[57] This is the case both where amounts payable to the project company under a project agreement that has been assigned to the security agent are dealt with as described in para. 11.84 above and where the project company is permitted to withdraw moneys from a charged bank account as described in para. 11.85 above.

[58] The *Spectrum Plus* debenture purported to create a fixed charge over book (and other) debts and then restricted the chargor's ability to deal with those debts in the following terms: 'with reference to book and other debts hereby specifically charged [Spectrum] shall pay into [Spectrum's] account with the Bank all moneys which it may receive in respect of such debts and shall not, without the prior consent in writing of the Bank sell factor discount or otherwise charge or assign the same in favour of any person or purport to do so and [Spectrum] shall if called upon to do so by the bank from time to time execute legal assignments of such book debts and other debts to the Bank.' The book debts were paid into an overdrawn account with the bank, but Spectrum remained free to draw on the account until the overdraft limit was reached. The House of Lords concluded that Spectrum's continuing contractual right to draw out sums equivalent to amounts paid in to the account was 'wholly destructive' of the argument that there was a fixed charge over the uncollected proceeds of the book debts, and so held the charge was a floating charge.

11.95 Does it matter? There are disadvantages with a floating charge[59] but these really only present themselves in an insolvency. In the context of cross-border project financing transactions where financial problems suffered by the project are in almost every instance dealt with by means of some sort of consensual restructuring, the answer is that in truth it matters not whether a charge in favour of the lenders is fixed or floating.

Financial collateral

11.96 The EU Directive on Financial Collateral Arrangements (Directive 2002/47/EC) establishes a degree of harmonization in the method and legal effect of entering into financial collateral arrangements, its purpose being to remove obstacles to the use of 'financial collateral' and to minimize the formalities required to create or enforce security over it. The directive has been implemented in the UK by way of the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226) (the 'Financial Collateral Regulations'), which, among other things, seek to:

(1) remove almost all the formal requirements with respect to creation, validity, perfection (including registration), admissibility in evidence, and enforcement of financial collateral arrangements (the only formalities to be satisfied being, as discussed below, that the arrangements must be in writing and that there must be a transfer of possession or control of the financial collateral); and
(2) establish clear conflict of laws rules for the treatment of book-entry securities that are used as collateral.

11.97 There are thus distinct advantages afforded to the parties to a financial collateral arrangement that falls within this legislation, and in particular to those in whose favour security over the financial collateral is granted.

11.98 The Financial Collateral Regulations only apply to 'financial collateral', which is defined as 'cash or financial instruments', although this definition is to be extended to cover the taking of security over 'credit claims' (these being 'pecuniary claims arising out of an agreement whereby a credit institution . . . grants credit in the form of a loan').[60]

11.99 In order to fall within the scope of the Financial Collateral Regulations:

(1) the collateral must be in the possession or control of the collateral-taker;

[59] The most notable disadvantages are a longer 'hardening' period, the postponement of the claims of the holder to certain claims of employees and the costs of the relevant insolvency proceedings and the fact that a prescribed part of the proceeds realised on enforcement of the charge will be earmarked for the benefit of the company's unsecured creditors.

[60] The Financial Collateral Regulations are to be amended to implement EU Directive 2009/44/EC on settlement finality and financial collateral arrangements (which, among other things, amends the EU Directive on Financial Collateral Arrangements) by 30 December 2010.

(2) both the collateral-taker and the collateral-provider must be non-natural persons (which is to say that neither may be an individual);
(3) the arrangement must be evidenced in writing (rules which require that the collateral instrument be signed or that the arrangement be entered in a register being disapplied); and
(4) there must be a connection with the EU, whether through a choice of law provision or through the location of the asset or performance of a contractual obligation.

11.100 The fact that the Financial Collateral Regulations require the collateral to be in the possession or control of the collateral taker means that assets the subject of a floating charge will be excluded from their scope unless it has crystallized (because the essence of a floating charge is that until then the chargor is free to deal with the assets thereby charged) and the collateral-taker has then taken appropriate steps to exercise control over the assets. This is so (and whether the charge is a floating charge by its express terms or virtue of being characterized as such as discussed in paragraphs 11.91–11.95 above) because notwithstanding the fact that Financial Collateral Regulations expressly include floating charges within the definition of security financial collateral arrangements, they do not elaborate on what constitutes possession or control of collateral beyond recognizing that substitutions or withdrawals of excess collateral will not of themselves prejudice the control of a collateral-taker.[61]

Permitted investments

11.101 Whilst it is ultimately the sponsors of a project that benefit most from good cash management in relation to the project's cashflows (because there is obviously a direct correlation between their equity return and the profitability of the project company), the lenders are also interested in good cash management because it means that the financial tests of the project's performance provide a more accurate picture of underlying business of the project. Although funds standing to the credit of a project company's bank accounts can be expected to earn interest, with interest on term deposits and larger balances accruing at more favourable rates than on current account balances, it is unlikely that the rates of interest offered by a bank with whom the project company is obliged to maintain its bank accounts will be higher than those offered by other banks or other creditworthy institutions. This being so, it is likely that good cash management will make it appropriate to use funds standing to the credit of the project company's bank accounts in the making of investments that generate a higher return than can be obtained by simply leaving the cash in its

[61] In Chapter 3 of its consultation paper published in August 2010 on the implementation of EU Directive 2009/44/EC, HM Treasury discusses the possibility of modifying the Financial Collateral Regulations so that they extend to all floating charges, but recognises specifically that such a change raises concerns because it would operate to the disadvantage of unsecured creditors who would be unaware of the existence of floating charges over financial collateral (because such floating charges would not be registrable).

bank accounts. As a result, the finance documents will usually contain provisions that allow the project company to invest moneys it believes to be surplus to its immediate needs.

11.102 One of the risks in any project is the risk associated with the creditworthiness of the creditors and potential creditors of the project, including the banks through whom the project company's revenues flow and with whom its positive cash balances are maintained. As a result, it is normal for the financing documentation to stipulate that the project company is not permitted to open or maintain bank accounts with banks without a minimum specified credit rating. In the same way, the definition of the investments in which the project company is permitted to invest will look to (among other things[62]) the creditworthiness of the relevant obligor.

11.103 In addition to the question of whether a charge over permitted investments is fixed or floating,[63] there is an inherent difficulty in knowing whether the security document pursuant to which the security over the bank account containing the money used to purchase the investment is appropriate to create effective security over the investment, whether this is because of the nature of the investment itself or because of conflicts of laws rules that apply in the particular circumstances (or both).[64] Although it is possible to deal with both these issues by introducing appropriate limitations in the definition of permitted investment, in order for this approach to work from the lenders' perspective, it will either need to be overly prescriptive (which is not necessarily a straightforward exercise) or it will need to allow the lenders the right to determine whether they are happy that their security arrangements apply to any given proposed permitted investment.[65] Perhaps surprisingly, it is more

[62] Permitted investments will invariably be restricted to reasonably short-term, publicly quoted debt obligations issued by governments and bank and other corporate issuers having a minimum specified investment grade credit rating. The currency of the obligations will also be restricted so that the investment does not give rise to any foreign exchange risk.

[63] See paras. 11.91–11.95 above.

[64] Investments in publicly quoted securities are more often than not held through intermediaries (by credit to 'investment accounts' of some sort) rather than directly. Indeed, in most instances securities are held through tiers of intermediaries, with the investor having an account with one intermediary and that intermediary having an account with another in a different jurisdiction (Euroclear in Belgium or Clearstream in Luxembourg, for example) in which are recorded all the relevant securities held by the first intermediary for all its customers (including, in particular, the ultimate beneficial owner of the investment, i.e. the project company).

Under English common law and conflicts of laws rules, the law that will determine the efficacy of a security interest granted in relation to registered securities credited to an investment account with an intermediary will be the law of the jurisdiction where the account is maintained. Coincidentally, EU law on this point (the relevant EU Directives being 02/47/EC (Financial Collateral Arrangements), discussed in paras. 11.96–11.100 above, and 98/26/EC (Settlement Finality in Payment and Security and Settlement Systems)) is the same, the rule being generally referred to as the PRIMA rule (the 'place of the relevant intermediary approach').

[65] Neither of these approaches will be particularly attractive to the project company or the sponsors. However, given the fact that the point goes to the heart of one of the fundamental terms of the financing, the point is not one in relation to which the lenders have much scope for making concessions.

common for the financing documents to adopt the latter approach. This is certainly simpler from the point of view of the documentation and the legal analysis that would otherwise have to be undertaken, and whilst in effect it leaves the lenders with a right to approve permitted investments that the project company might wish to make, it can be regarded as a sensible result, not least because at the time the financing agreements are being negotiated the actual investment opportunities that will be available to the project company when its project becomes cashflow positive are unknown.

Insurances

11.104 The security for a project will include assignments of the project company's interest in the insurances that it is required to take out in connection with the project as well as (where applicable) assignments of any offshore reinsurance policies that the primary insurers are required to maintain. Chapter 6 considers all aspects of the insurance and reinsurance arrangements in relation to projects, both from the perspective of the project company and its shareholders and the perspective of the lenders.

Direct Agreements

11.105 The idea of a project company granting security over its assets for its borrowings so that, if circumstances are such that the project company is unable to meet its liabilities as and when they fall due, the lenders to whom that security has been granted can sell the assets and apply the proceeds to recoup the moneys that are owed to them (accounting to the project company for any surplus funds that may exist following that application) is quite straightforward. A degree of complication arises where the assets being used as security consist of contractual rights because when creating security over contractual rights it will be necessary to involve third parties in the security arrangements, if only to give them notice of the assignment by the project company of its claims against them and to request them to confirm that they have received the notice.[66] Even then, however, the basic idea is simple.

11.106 However, notwithstanding the simplicity of the theory, as can be seen from the discussion in the section on security taken over contract rights in paragraphs 11.75–11.82 above, the reality is that the complexities of the project contracts themselves

[66] As discussed in paras. 11.81 and 11.83–11.85 above, an assignment of a party's rights under a contract can only be binding on the counterparty to the contract once he has been given notice of the assignment. Quite apart from being perfectly obvious, this is also the position under English law, both in equity (*Stocks v Dobson* (1853) 4 De GM & G 11) and also at law (under s 136 of the Law of Property Act 1925, which stipulates that in order to be effective at law an assignment of a debt or other thing in action must be an absolute assignment and in writing under the hand of the assignor and written notice of the assignment must be given to the debtor).

means that the simple model of an assignment of the contracts coupled with notices of the assignment to the relevant counterparties requires considerable refinement if it is to work in a way that protects the interests of the lenders without adversely affecting the ability of the project company and the counterparties to the various contacts to exercise their respective rights and perform their respective obligations thereunder.

11.107 Although it is something of an over-simplification, in practice the lenders will end up having to enforce their security interests (and therefore look to direct agreements) only in cases where the problems that the project company has encountered are such that it cannot continue to discharge its obligations to its creditors as and when they fall due. So long as the project company is able to continue to trade (even if that requires some sort of work-out and a restructuring of the project company's finances), it is unlikely that the lenders will wish to enforce their security.

11.108 Security over the project agreements to which the project company is a party coupled with a direct agreement should not be seen as a luxury in cases where the lenders also hold security over the shares of the project company. Whilst the share security would enable the lenders to take control of the project by replacing the project company's directors and senior management, there could be legal impediments to doing this in the relevant jurisdiction. This approach might also be both politically difficult (because, for example, it could involve the seizure of shares owned (directly or indirectly) by a government, a pension fund or individual employees) and commercially unattractive (because the project company is likely to be burdened with liabilities that would obviously continue notwithstanding a change of the project company's management).

11.109 Whilst direct agreements can be regarded as ancillary to the main project agreements, they should not be regarded as of secondary importance. If a project has encountered problems of a magnitude that they have resulted in the lenders having to take steps to enforce their security, particularly before the project is complete, the various stakeholders in the project will all be looking at ways to minimize the losses they are likely to suffer in the circumstances, if at all possible at the expense of the other parties. Recriminations will abound and everyone will be looking at the contractual documentation with microscopes. The result? Everything in the documentation that works to the advantage of one of the parties will first be magnified and then exploited to the fullest extent possible.

11.110 This being the case, whilst a 'good' direct agreement (which is to say one that has been properly thought through from both commercial and legal perspectives) will not actually improve the situation for any of the parties, one that is anything less than good for some reason has considerable potential for making matters far worse for at least one of the parties than they should be.

11.111 From the lenders' perspective, there are two key benefits to a direct agreement:

(1) It provides a pre-agreed route that the lenders[67] can use as a means of 'stepping into the shoes' of the project company under the contracts over which they have security so that they can take day to day control of a project which has run into trouble in order to protect their own interests.
(2) It provides them with a legally binding promise from the counterparty to the relevant project agreement that it will not exercise its rights of termination thereunder except as and when, and to the extent, specified in the direct agreement.

11.112 From the perspective of the counterparty to the relevant project agreement (except, of course, where the counterparty is itself the cause of the project's problems), there are three key benefits to a direct agreement:

(1) In all probability[68] it will provide the counterparty with a pre-agreed route to extricate itself from the contract with the project company (which is what it would be doing if it were to exercise its termination rights) in return for a promise to do what it would have been obliged to do had the project company performed its obligations under the contract.
(2) It will (again in all probability), provide the counterparty with a promise by the lenders that all overdue amounts owed by the project company to the counterparty (or at least an agreed proportion of them or, perhaps, those overdue by more than an agreed period) will be paid on an agreed basis, so that, for example, some of the arrears are payable only out of any future positive cashflows that the project is able to generate.
(3) It will include restrictions on the exercise by the lenders of their rights to assign the rights under the project agreement that have been assigned to them by the project company. The relative importance of these restrictions obviously varies from project to project, but in the case of projects with new or proprietary technology, defining the restrictions can be both time consuming and difficult because there will be a considerable divergence of interests on this point between the lenders (who will want to have minimal restrictions in order to maximize the pool of potential purchasers should they opt to sell the project as part of the

[67] As a practical matter it will never be the lenders themselves (or the security agent) that actually 'steps-in'. The person that actually steps in will be a special purpose company of some description established for the purpose. Irrespective of how this vehicle company is owned and funded (which will depend on the particular circumstances), it will ultimately be the lenders that control what it does once it has stepped-in.

[68] It can only be a probability because the direct agreement will not give the counterparty the right to require the lenders to exercise their step-in rights. All the counterparty has, therefore, is the knowledge that it is likely that if the project company cannot be made to continue to function in a way that will enable it to continue with the project, self interest will drive the lenders to exercise their option to do so.

security enforcement process) and the counterparties (who will want to impose as many restrictions as possible to minimize the risk of their technology being made available to actual or potential competitors).[69]

11.113 Direct agreements are usually structured in a way that allows the lenders to step-in either permanently (in which case the direct agreement will contain a novation mechanism such that the original project agreement is replaced altogether) or temporarily (in which case the parties rights and obligations under the original project agreement will be suspended until such time as the lenders exercise an option in the direct agreement to 'step-out' and thereby reactivate the original contract).

11.114 The main commercial points that will fall to be negotiated in relation to a direct agreement will be the matters mentioned in paragraphs 11.111–11.113 above, though of course there will be ancillary provisions such as covenants by the counterparty not to agree changes to the underlying project agreement without the lenders' approval and mutual confidentiality provisions.

Legal Opinions

Purpose

11.115 Legal opinions are included in this chapter because whilst they are not themselves finance documents (because they do not give rise to any rights or obligations between the project participants *inter se*), they both influence the terms of the finance documents and act as one of the key triggers in relation to the activation of the project participants' rights and obligations under the finance documents.

11.116 The issuance of formal legal opinions in relation to project financings serves as a confirmation to the lenders that:

(1) the project is being developed in accordance with the laws of the jurisdiction in which it is located; and
(2) the obligations that the various project participants have agreed to perform in connection with the furtherance of the development of the project, its financing, and its operation are binding obligations.

11.117 Formal legal opinions from local and international counsel are often the last of the conditions precedent that fall into place on the date of financial close, which is the date on which all parties accept that all (or at least virtually all) their obligations under all the project and financing agreements become unconditional. It is important, of course, to bear in mind that although formal opinions are issued at the end

[69] The extent of the lenders' ability freely to transfer their interests in the project to third parties should they need to enforce their security will form part of the overall risk matrix for the particular project.

of the process of documenting the development and financing arrangements for a project, the parties will require and receive legal advice on the different laws (in particular in the jurisdiction in which the project is located but elsewhere as well) that will or may have implications for their plans. Although in some ways the formal legal opinions issued at closing are a distillation of much of this historic legal advice, they should not be assumed to constitute the complete legal analysis of the project. That will be embodied primarily in the legal due diligence report (and supplemental opinions and memoranda relating to it) that will have been prepared for the transaction. An understanding of the full legal picture, therefore, requires a review of both the due diligence report and the formal closing opinions.

11.118 Although perhaps axiomatic, legal opinions are intended to deal with matters of law and the legal consequences of documents and acts. They are not intended to confirm matters of fact. The project and financing agreements will contain representations as to matters of fact and as to matters of law because both are relevant as part of the risk allocation arrangements for the transaction. A lawyer (or a law firm) issuing an opinion can, of course, be requested to confirm, for example, that the relevant contracting party is not in the midst of litigation that might have an adverse impact on its creditworthiness or its ability to perform its obligations under the project documents, but such a confirmation is unlikely to be given. Even if given, it will achieve very little. If the confirmation is requested of an independent law firm, they will need to rely on a statement of the position made to them by the party on whose behalf they are issuing the opinion (because only that party will actually know the facts), so the addressees of the opinion will get nothing more than they get through the representations in the relevant contract. If it is requested of in-house counsel (and the circumstances are such that it is reasonable for him to be expected to know whether there is any such litigation), all the addressees of the opinion will gain over and above the representations in the relevant contract is a potential claim against the individual that issued the opinion (which it would be very surprising to see them pursue).

First in country

11.119 Although it might be more logical to include a discussion on legal opinions in Chapter 4 on the basis that a legal analysis of the rules and regulations in the different jurisdictions relevant to the ownership, development, financing, and operation of a project is a key element of the overall assessment of the risks associated with (and therefore the risk allocation in relation to) the project, it is probably fair to say that it is only where a project is one of the first of its type in a particular country that legal opinions are key to the risk assessment with respect to a project. That is not to say that legal risks are unimportant in 'repeat' deals in the country. Rather it is to highlight the fact that in relation to transactions where there is an established precedent for dealing with identified legal risks, the risks blend into the background—they move naturally from being the brightly coloured new chair that needs to be moved

around a room when it first arrives so that everyone can get used to it and decide where it should stay into being simply a part of the existing furniture in the room with which everyone is familiar (and therefore comfortable).

11.120 The local law legal opinions on 'first in country' deals will take time to finalize as counsel in the local jurisdiction develop their conclusions with respect to the rules that might affect the efficacy of different provisions of the project agreements and the financing agreements (and in particular the security documents).

11.121 Projects often raise novel and difficult technical legal questions in the jurisdictions in which they are located, not all of which will have clear-cut answers and many of which will require counsel to consider new rules and regulations. In many instances, these new rules and regulations are promulgated by newly appointed officials and regulators who are themselves developing their thinking on the best way to approach issues that they had not had to consider previously or which they had historically dealt with in a particular way. As a result, it is often the case that some elements of the laws that affect a project may actually be moulded to address issues identified in the course of the legal due diligence and opinion process and which are of particular concern, whether to the sponsors or the lenders (or both).

11.122 Issues raised by local counsel on 'first in country' deals will invariably lead to the inclusion of particular provisions in the project agreements in order to mitigate identified legal risks in an agreed way (or simply to ensure that the agreements make it clear how particular legal risks are being allocated among the parties).

Types of opinion

11.123 The classic opinions for project financing transactions are no different to the opinions seen in other types of financing transaction (with the 'usual' raft of assumptions, reservations and qualifications and, in the case of the opinions of counsel in the jurisdiction in which the project is located, whatever additional assumptions, reservations and qualifications are appropriate in the particular circumstances). Opinions broadly fall into three categories:

(1) corporate opinions;
(2) enforceability opinions; and
(3) combined corporate and enforceability opinions.

Corporate opinions

11.124 Corporate opinions are opinions from counsel in the jurisdiction of incorporation of the relevant[70] parties to the project and financing documents that confirm that

[70] Opinions are not normally sought in relation to the finance parties. However, in some instances it may be appropriate for an opinion to be issued in relation to the capacity of a finance party to enter into a particular arrangement. It would not be unusual, for example, to request a corporate opinion

those parties have the necessary corporate power to enter into and perform their obligations under the various agreements to which they are party and have done all that they need to do under the laws of their jurisdiction of incorporation and their constitutional documents to validly enter into those agreements.

11.125 Although addressed to the lenders, the corporate opinions relating to parties other than the project company itself will generally be issued by counsel acting on behalf of the relevant contracting party. Most sponsors and contractors with internal legal departments would expect to satisfy the requirement for a corporate opinion by delivering an in-house opinion. The only point to note in this context is that some financing institutions might require an internal approval before they can agree to accept anything other than a legal opinion issued by an independent law firm.

11.126 The opinion from counsel to the project company in its jurisdiction of incorporation (which in almost all cases will be the jurisdiction in which the project is located) will deal with corporate matters, project matters (such as governmental consents and the like) and the enforceability of the contracts to which the project company is a party and which are governed by local law. The opinion from local counsel to the lenders will ordinarily cover the same ground as the opinions of counsel to the project company and counsel to any of the other project participants incorporated in the same jurisdiction.

Enforceability opinions

11.127 These opinions essentially confirm that the project and financing agreements (including any security documents) as executed are 'legal, valid and binding'. These opinions also usually (and unsurprisingly) confirm that the relevant agreements are 'enforceable', although the use of the word 'enforceable' in this context is potentially confusing because, as mentioned in paragraph 11.62 above, it is more accurate to say that a contract is 'effective' rather than 'enforceable'.[71]

11.128 The normal English practice is for the enforceability opinions in relation to the financing agreements (including security documents) that are governed by English law to be issued by English counsel to the lenders and (but with less uniformity from transaction to transaction) for the opinions in relation to the project agreements that are governed by English law to be issued by English counsel to the

in relation to a bank that is to issue a performance bond in favour of the authority responsible for granting the operating licence required by a project.

[71] What is meant by 'enforceable' in the context of a contract does not mean that a court will make an order requiring a party to perform its obligations under the contract but that it will make an order (i.e. an order requiring the payment of damages) that obliges a party that has failed to perform its obligations under a contract to pay monetary compensation to the innocent party for losses he (or she) has suffered as a result of that failure. At common law, the only obligation under a contract that a court will compel a party to perform is an obligation to pay a fixed sum of money. An order for specific performance of any other obligation is only available in equity, and as such is subject to limitations.

project company. The logic for this division is that whilst counsel to the lenders are heavily involved in the preparation and negotiation of the finance documents (even in cases where counsel to the project company has primary drafting responsibility for them), their more limited involvement in relation to the development and finalization of the project documents means that they are less well placed to issue an opinion that highlights any particular issues that, for the benefit of all concerned, is better raised and dealt with on a commercial level before financial close. However, this is not to say that counsel to the lenders are likely to miss things in the project agreements (and indeed it is not uncommon for counsel to the lenders to agree to opine on the project agreements even though they have not been directly involved in their preparation).

12

PROJECT FINANCE IN CIVIL LAW JURISDICTIONS

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Introduction

The origins of project financing under civil law

12.01 Civil law countries, such as France, have a long project financing history, having its roots in the concession system originated in Roman times up to and including the evolution of public private partnerships (PPPs) in the early twenty-first century.

12.02 However, notwithstanding this long history, the rules governing the concession system have never been comprehensively organized in many civil law jurisdictions. In France, despite the fact that the concession system was often used during the nineteenth century and that some important parts of the national infrastructure and of the national economy became dominated by the concession regime, no precise legal definition of the concession existed before the end of the nineteenth century. The concept of delegation of public service (*délégation de service public*) only became the basis of the concession system through administrative case law, practice, and doctrine at the end of the nineteenth century and beginning of the twentieth century.[1]

12.03 Nowadays, there is a major distinction between a number of different kinds of contracts entered into by the private sector and the public authorities. Two main categories of contract exist, the delegation of public services (concession or *affermage* of a public service) and the public procurement contract whether for public works, procurement or services (*marché public*) including PPP contracts.

12.04 The main characteristics and features of project financings were developed together with the implementation of public infrastructure projects through the concession system that allows the government to place the burden of the costs of investment on the private sector.

12.05 Typical projects in civil law countries are operated by the private sector on the basis of the following contracts.

Concession or affermage contract (conventions de délégation de service public)

12.06 The concession is an agreement under which a public authority grants to a private company (the *concessionaire*) the operation of a public service. The *concessionaire* is responsible for running the service within the framework settled by the public authority granting the concession and the service is typically paid for out of revenues received from the users of the service. The main characteristic of a concession is that the running of the service by the *concessionaire* is made at its own risk (*à ses*

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[1] The *commissaire du gouvernement* defined the meaning of a concession in the leading case of *Gaz de Bordeaux* (CE 30 March 1916): 'the concession is a contract under which a public authority grants the responsibility for the construction of a public infrastructure or the operation of a public service to a person or a private company, at its own cost, with or without subsidies, and which is remunerated through the operation of the service out of the revenues received from the users of the service.'

risques et périls). This essentially means that the concessionaire recovers the costs of construction of the infrastructure and operation of the service from the revenues generated by the service and paid for by the users.

12.07 The distinction between a concession and *l'Affermage* lies essentially in the financing of the initial infrastructure. If the concessionaire has to finance the construction of the infrastructure used to render the delegated public service, the contract is a concession. In *l'Affermage*, the public authority finances and provides the infrastructure that the delegate operates. The public authority at the end of a concession often proposes an *Affermage* contract, as the investment to build the infrastructure has already been made.

12.08 Local transport services in France are typically operated by private companies which have concessions from local municipalities to provide public transport in their area. Users of the transportation system pay these companies for the service. Although both operator and consumer are private persons and enter into private law contracts, the concession or *l'Affermage* itself is an administrative contract between the State, the local government ('*collectivités territoriales*') and the transport company.

Public Private Partnerships (contrats de partenariat public privé)

12.09 Based on the UK's Private Finance Initiative (PFI) model, France, like other civil law jurisdictions, passed in 2004 general legislation relating to PPPs.[2] However, this legislation had to be amended several times to address certain difficulties which become apparent during the first years of PPPs, as the French government expressed the desire to 'make the partnership contract an instrument that fully finds its place in government administration, and not a simple tool of exception'.[3]

12.10 The two main differences between PPPs and concessions lie in (i) the way the project is designed and (ii) the remuneration of the private company. In contrast to a concession, it is left to the private company to design the project according to the requirements of the public authority and the project company receives a pre-agreed remuneration over the life of the project covering investment costs (including the financing costs) and operating costs. The project company is therefore remunerated by the public authority rather than the users of the services.

Power Purchase Agreement—PPA

12.11 Simultaneously with the privatization of the energy sector and the separation between the production and the distribution of electricity, the financing of

[2] Before the general regulation of 2004, only specific areas could be subject to public private contracts in relation to security or health matters (mainly projects related to the building of jails and hospitals). Since 2004, public private contracts can be used without limitation in respect of all areas, provided that the projects have a certain degree of urgency or complexity.

[3] Extract from the Council of Ministers report of 13 February 2008, on presentation of the law on public private partnership contracts.

power projects based on power purchase agreements has taken an important role in the energy sector. The PPA is a contract entered into between a private producer of electricity and the national electricity distribution company.

12.12 An example of this new approach in the power sector was the implementation in 2000 and 2001 of a general regulatory framework relating to the production and distribution of energy (including renewable energy). This framework is based on the obligation of the national electricity company (*Electricité de France* or EDF) to buy electricity generated from renewable sources, such as co-generation plants, wind turbines, or solar energy, under long-term power purchase contracts (with terms of between fifteen and twenty years) at tariffs set by the government. A key aspect of these kind of projects is that the project company does not bear the market risk as all electricity produced is mandatorily purchased at a pre-agreed tariff.

Public Projects and Tender Offers

12.13 In the framework of the EU regulations on public procurement, the award of public procurement contracts must comply with general principles set forth by the relevant EU directives.

EU Procurement Directives

12.14 The legal framework for public procurement in the EU is governed by the following EU Procurement Directives:

(1) Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts; and
(2) Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water and energy sectors.

12.15 These directives apply when public authorities and utilities seek to acquire supplies, services, or works (for example, civil engineering or construction) and provide that the awarding of public procurement contracts must comply with general principles of freedom of access to public bidding, non-discrimination, equal treatment of bidders, publicity and transparency of procedures, in order to ensure efficient competition between operators and the proper use of public funds. The EU directives apply to PPP contracts.

12.16 According to provisions of the EU Procurement Directives, public procurement contracts must generally be concluded after specific publication procedure has been complied with, and call for competition has been issued. This allows public bodies to

tender to several competitors and choose their contracting partner through objective criteria, with strictly regulated exceptions.

Implementation in France—concessions and Public Private Partnerships

12.17 Under French national law, all PPP contracts must comply with a large number of regulations and rules deriving from general administrative law and the EU Procurement Directives.

12.18 Each category of PPP contract is governed by specific internal French regulations. However, these regulations have in common that they require a prior call for competition before awarding a contract.

12.19 The objective of requiring a prior call for competition is to award public contracts on the basis of objective criteria which ensure compliance with the principles of transparency, non-discrimination, and equal treatment and which guarantee that tenders are assessed in conditions of effective competition.

12.20 In order to comply with the principle of equal treatment in the award of contracts, the prior call for competition must ensure the necessary transparency to enable all tenderers to be reasonably informed of the criteria and arrangements which will be applied to identify the most economically advantageous tender. Therefore, the public authority must indicate the criteria for the award of the contract and the relative weighting given to each of those criteria in sufficient time for tenderers to be aware of them when preparing their tenders. In order to guarantee equal treatment, the criteria for the award of the contract should enable tenders to be compared and assessed objectively.

12.21 The main procedures to award public contracts are:

(1) the call for tenders; and
(2) the competitive negotiation.

The call for tenders

12.22 The call for tenders is the procedure through which the public entity chooses the economically most advantageous tender, without negotiation, on the basis of objective criteria brought to the prospective bidders' attention beforehand. This procedure is based exclusively on objective criteria mentioned in the publication notice, and the public body is not allowed to negotiate with tenderers.

12.23 As a result, only two award criteria are applied: 'the lowest price' and 'the most economically advantageous tender'.

The competitive negotiation

12.24 In the case of particularly complex contracts, the public body can enter into competitive negotiations with tenderers.

12.25 The purpose of the competitive negotiation is to discuss, on the basis of a functional plan (*programme fonctionnel*) that has already been drawn up, all aspects of the contract with the selected bidders (for example, technical/financial and legal aspects). During the negotiation, the public authority is obliged to ensure equality of treatment among the bidders. In particular, the public authority cannot give information to certain bidders which might give them an advantage over others and cannot reveal confidential information provided by other bidders. The final offer of the bidders is then submitted after the competitive negotiation.

12.26 Concession contracts are also subject to compliance with the general principles described above (transparency, non-discrimination, and equal treatment), although specific procedures may be implemented on a case-by-case basis. The public authority is entitled freely to organize such procedures without the formal requirements of a call for tenders or competitive negotiation provided that these rules ensure compliance with the general principles of transparency, non-discrimination, and equal treatment.

Consequences of breaches by the public authority of the prior call for competition

12.27 Non-compliance with the mandatory regulations prior to awarding a public contract may render the public contract null and void and therefore lead to its cancellation. The cancellation of the award of the '*Boulevard Périphérique Nord*' concession in the 1990s is a good example.

12.28 The nullity of a public contract is retroactive. The latter is therefore deemed to have never existed. The consequences of a public contract being declared a nullity includes financial implications which are of particular concern to the lenders (including the incurrence of hedging breakage costs).[4]

Creating and Perfecting Security Interests

Floating charges and pledges over business concerns in civil law jurisdictions

12.29 In civil law jurisdictions, no specific global security interests over assets can be perfected since the concept of the floating charge does not exist, subject to one exception: a pledge over a business concern. Therefore, the assets (taken as a whole) of a project company cannot be charged by way of security. Specific security interest instruments must be implemented for each type of asset, which requires the implementation of numerous security arrangements depending on the nature of the assets of the project company.

[4] See para. 12.149 et seq.

12.30 Civil law jurisdictions generally provide for a large range of security interests concerning specific assets (for example, cars, boats, aircraft, machines, inventory, etc.), to each of which specific legal provisions apply as regards the granting, registration (as the case may be), perfection and/or enforceability of the relevant security interest.

Pledges over business concerns

12.31 The business concern of a company (which mainly comprises a range of intangible and tangible assets on the basis of which a commercial business is carried on) can be pledged in almost all civil law jurisdictions. However, the assets comprised in the business concern of a company which may be subject to this type of security are strictly limited and do not allow the creditors to perfect a security interest in some of the key assets of a project company. Adherence to the required formalities is also of key importance with respect to this type of security.

Assets included in a pledge over a business concern

12.32 The pledge may solely cover the assets which are restrictively listed in the regulations governing this type of security. Assets which may generally be included in the pledge over business concern are:

(1) the trade name ('*enseigne*');
(2) the corporate name ('*nom commercial*');
(3) the leasehold right ('*droit au bail*');
(4) the clientele and customers ('*achalandage*');
(5) the commercial equipment and tools used for the operation of the business concern; and
(6) the patents, licences, trademarks, industrial drawings and designs, and more generally the intellectual property rights attached thereto.

12.33 Some of the assets are by law included in the pledge over a business concern (i.e. trade and corporate, leasehold right, clientele and customers). The other assets are included in the scope of the pledge only if the parties elect to do so and expressly provide in the agreement itself a description of the relevant assets (i.e. patents, trademarks, equipment and tools).

12.34 Consequently, the deed of pledge must precisely and expressly state the items of the business concern which are subject to the pledge.

Assets excluded from the pledge over business concern

12.35 Most of the key assets of a project company are excluded from the scope of the pledge over the business concern. The following assets, which are of a particular relevance to creditors, cannot be pledged through this type of security:

(1) inventory;
(2) property (buildings);

(3) receivables;
(4) rights arising from contracts (other than leasehold rights);
(5) bank accounts; and
(6) future assets (other than those replacing existing assets).

Formalism

12.36 In most of the civil law jurisdictions, a pledge over a business concern must be recorded in a notarial deed ('*acte authentique*') or in a duly registered private instrument ('*acte sous seing privé, dûment enregistré*').

12.37 The pledge deed (together with registration certificates ('*bordereaux d'inscription*')) needs to be registered at a registry held with the clerk of the commercial court in whose jurisdiction the business is operated and, as the case may be, in which jurisdiction each of the branches of the business concern included in the pledge are located.

12.38 The rights resulting from the contractual pledge will be created by the registration and such registration date will determine the priority among the secured creditors.

12.39 Following the registration, the pledge over the business concern is generally valid for a limited period of time (ten years as far as pledges over business concerns governed by French law are concerned and five years as far as OHADA countries are concerned) unless the registration is renewed before the expiry of these deadlines.

Rights of creditors

12.40 The secured creditor benefits from a priority right ('*droit de priorité*'), which means that the secured creditor is entitled to be paid in priority from the sale of the business concern by preference over the unsecured creditors. The creditor's rights are linked to the secured assets so that the priority of the secured creditor follows the business concern into whichever hands it may pass.

12.41 The secured creditor does not benefit from a retention right ('*droit de rétention*') or a right to require from a court that the business concern be transferred to him following foreclosure ('*droit d'attribution*'). The secured creditor has, however, the right to apply to a court to order the sale of the pledged business concern as a whole, eight days following notice to pay made to the debtor. A pledge over the business concern does not permit foreclosure over specific assets or types of assets included in the business concern subject to the pledge. From that perspective, it is essentially regarded as a defensive security which is rarely enforced but which puts the lenders in a strategic negotiation position in the framework of an insolvency proceeding.

Security interest by type of assets

12.42 In addition to special regimes applicable to specific types of assets (for example, cars, boats, aircraft, and business concerns), security can be classified in civil law jurisdictions in three categories:

(1) mortgages over real property;
(2) security over tangible moveable property; and
(3) security over intangible moveable property.

Mortgage over real property—mortgage and lender's purchase money security interest

12.43 Security interests which can be perfected over real property in civil law jurisdictions are (i) mortgages and (ii) purchase money security interests (i.e. a lender's lien granted where the lender's claim results from a loan solely used by the borrower for the purpose of discharging the acquisition price of the relevant property). The latter is less likely to be used in the context of a project financing.

Mortgage

Nature and form of the mortgage

12.44 A mortgage is a lien granted over real property by the grantor of the mortgage to the grantee of the mortgage as security for a debt owed typically by the mortgagor to the mortgagee. The mortgagor is left in possession. The mortgage grants in favour of the mortgagee:

(1) an ancillary right, which means that the security is linked to the debt itself and the mortgage is deemed extinguished if the debt is repaid;
(2) a right to pursue the forced sale of the real property in whatever hands the property is held ('*droit de suite*'); and
(3) a priority ('*droit de préférence*') over the sale proceeds of such real property provided that the mortgagor is not subject to an insolvency proceeding where special considerations apply.

12.45 A mortgage is intentionally created pursuant to a consensual deed executed by, at least, the mortgagor and the mortgagee with the assistance of a notary.

12.46 In order for a mortgage to be valid, perfected, and enforceable and to have full effect, it must:

(1) be drafted and executed by a notary and therefore drafted in the language of the relevant country where the real property is located;
(2) be executed in the country of location of the real property;
(3) describe the specific nature and location of the mortgaged property;
(4) provide for the amount secured; and
(5) be registered by the notary with the land registry.

12.47 The notary has sole responsibility *vis-à-vis* the lenders as regards the validity and enforceability of these security interests thereby rendering title insurance unnecessary.