Insights

IMPEDIMENTS TO RECOVERY OF THE INFRASTRUCTURE LENDING MARKETS AND WHAT TO DO ABOUT THEM

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SUMMARY

This article reminds us how the manner in which the World Bank provides loans to developing market jurisdictions may restrict the ability of project companies to raise funds in the international infrastructure and project finance lending markets.

The topic may be especially relevant at this time, as the world begins to re-start growth and development of infrastructure assets following the enforced slow-down resulting from Covid 19.

These funding problems are not new; since inception of the World Bank over seventy years ago, its sovereign lending terms have proven a potential obstacle to developing infrastructure assets in jurisdictions where local policies provide that such assets need to be owned by the host government – and the problems may arise whether owned wholly or partly, directly or indirectly. The issue has recently been encountered across multiple project finance sectors including oil and gas, renewables, conventional power, petrochemicals and transport projects.

This article also explores some of the solutions and potential workarounds to these problems, including innovative approaches recently seen in the project finance market.

Introduction to the Problem

International project financings are secured transactions in which lenders have the benefit of a collateral package. An optimal collateral package is designed to provide lenders with various rights and remedies which should include, among others:

(i) the right to sell the project company as a going concern - this would primarily take place by way of enforcement of lenders' security provided by shareholders over their direct or indirect shareholdings in the project company;
(ii) the right to sell individual assets of the project company and the right to take control of project assets such as commercial contracts and project revenue streams – this would take place by way

of enforcement of security granted by the project company; and
(iii) the right to enforce against third party security - if any has been provided in relation to project debt.

Problems may arise in relation to project financings in jurisdictions where a host government (or an entity it owns or controls) possesses any kind of shareholding in the project company or where the host government is required to provide third party security for the benefit of project lenders. In those circumstances, if the host government has previously borrowed money from the World Bank, the financing documentation previously entered into with the relevant World Bank entity may effectively prohibit government entities from granting security to project lenders due to the operation of the World Bank Negative Pledge clause ("**WBNP**"). Lawyers and other commentators frequently refer to the WBNP as being an "effective" prohibition on the granting of security because, depending on the circumstances, that will be the practical effect, even though the legal position is not as straightforward as that.

The World Bank Negative Pledge

These days, negative pledge clauses in market standard cross border financing documentation include a basic prohibition on borrowers granting security upon or with respect to any of their present or future assets. Project participants will generally proceed to negotiate and agree specific carve outs and exceptions to the basic prohibition on granting security, the aim being to strike a balance between protection for lenders and ensuring borrowers are able to carry on their day to day business effectively. The theory behind this type of provision is to try to ensure that, should lenders need to enforce their security in respect of claims for repayment of debts owing to them, the assets of the borrower should still be available to such lenders and sufficiently unencumbered to satisfy such claims.

The WBNP is different to negative pledge clauses found in customary finance documentation in that, if it is triggered, it does not prohibit the granting of security *per se*. Instead, subject to certain exceptions, it requires borrowers who grant security in favour of other creditors to grant equal and rateable security in favour of the World Bank or, if that is not possible, to grant the World Bank security over equivalent public assets. In the case of perhaps the most relevant of the World Bank institutions – the International Bank for Reconstruction and Development (**IBRD**) - section 6.02 (a) of its General Conditions (which forms part of its financing terms) states as follows:

"*It is the policy of the Bank, in making loans to, or with the guarantee of its member countries not to seek, in normal circumstances, special security from the member country concerned but to ensure that no other Covered Debt shall have priority over its loans in the allocation, realization or distribution of foreign exchange held under the control or for the benefit of such member country. To that end, if any Lien is created on any Public Assets as security for any Covered Debt, which will or might result in a priority for the benefit of the creditor of such Covered Debt in the allocation, realization or distribution of foreign exchange, such Lien shall, unless the Bank shall otherwise*

agree, ipso facto and at no cost to the Bank, equally and ratably secure all Loan Payments, and the Member Country, in creating or permitting the creation of such Lien, shall make express provision to that effect; provided, however, that if for any constitutional or other legal reason such provision cannot be made with respect to any Lien created on assets of any of its political or administrative subdivisions, the Member Country shall promptly and at no cost to the Bank secure all Loan Payments by an equivalent Lien on other Public Assets satisfactory to the Bank."[1]

Originally, there were solid policy reasons behind the World Bank requiring this style of negative pledge in that when making certain types of development loans, the World Bank has not generally required sovereign borrowers to grant security over public assets. This has been an important point for sovereign borrowers. Instead, the World Bank has relied upon its credit assessment of borrowers on the assumption that its financings will remain unsecured. Creditworthiness of governments and public bodies they may own depend upon a range of factors but one of the most important is the ability of such debtors to access sufficient quantities of foreign exchange - i.e. local currency funding is not always such a concern - sovereign borrowers may simply print more money if there is concern about them meeting domestic obligations. Accordingly, the ability to repay in foreign currencies is one of the main risks which the WBNP seeks to mitigate and it is covered specifically within section 6.02 by reference to "*the allocation, realization or distribution of foreign exchange*". The resulting position is that whilst borrowers may theoretically agree to grant security in support of foreign currency financings provided by other creditors, they would need to take the severe step of ensuring that the rights of the World Bank remain *pari passu* with such other creditors by ensuring that security is granted "equally and rateably" in favour of the World Bank.

Equal and Rateable Security

Although in recent times requirements to create equal and rateable security are seen less often, these provisions do still arise across a variety of financial markets and products. One of several problems they present is the lack of clarity over what these provisions are supposed to mean in practice; indeed, legal commentators routinely disagree about the enforceability of these clauses. After all, under English law and New York law, let alone local laws commonly applicable in emerging markets, ranking of security and the related issue of "priority" are knotty concepts which depend upon a variety of factors. Here are just three examples of the issues which may arise in attempting to grant such equal and rateable security:

(i) One of the ways in which security is potentially vulnerable is that its value and worth may depend upon the date on which it is created and also the date upon which the debt to which the security relates is put in place. Without going into much technical detail here, there are particular aspects of bankruptcy and insolvency legislation applicable to many jurisdictions which mean that existing creditors (such as the World Bank in our scenario) and new third party creditors may not be treated *pari passu* in relation to priority of proceeds of enforcement of security: one creditor has an existing debt but "future" security, the other creditors have "new" debt but concurrent security. Questions may arise as to proper value being given for the security granted in respect of the original

financing. Questions may also arise as to whether the security is subject to "hardening periods" and if so, whether such periods run identically for both the original and new security.

(ii) Another example relates to situations where it may be important for security to be constituted behind a security trust. Without using the device of a trust, depending on the circumstances, including the governing law applicable to the security, the worth and value of security may be prejudiced in material ways to creditors. If there is a need to transfer the debt, it is possible for secured rights to be extinguished in this scenario.

(iii) The Latin phrase "*pari passu*" used in section 6.02 (a) has also caused problems over the years. It implies that the very fact of creating such Lien on public assets shall cause relevant loan payments owing to IBRD to be secured equally and rateably by such Liens. Whilst this may be implied, most commentators agree that positive action by way of new security documents would be required to implement such security.

(iv) As a final example of difficulties which may arise, where funds from the new lenders are being used by the project company to acquire assets, there are potential difficulties with trying to provide equal ranking security to the new and original lenders as the project company is unlikely to have the ability to deal with the legal title without the interest of the new lenders (as mortgagee) being dealt with in some way. There may never be a time (known in law as a "*scintilla temporis*") when the project company has unencumbered title to the assets and able to grant equal ranking security to the two sets of creditors.

To comply with the WBNP, these kinds of issues and many others are likely to signal a requirement for project finance parties to need to include the World Bank in their financing discussions and in all likelihood, a need for the World Bank and incoming project finance lenders to sign up to an intercreditor agreement or a common security trust deed. For those of us who have spent a relatively large portion of our lives sitting in Washington negotiating intercreditor and priority arrangements with World Bank officials, we are aware that involving the World Bank in this way should be avoided, if at all possible. To be fair to the World Bank organisations, they have a unique agenda and particular constitutional and policy requirements which are different, sometimes markedly so, from those of commercial banks and even to those of other multi-lateral development institutions. Nevertheless, it would be a brave (and one would think, potentially reckless) set of project participants who would decide to wheel in the World Bank for new sovereign debt negotiations in order to implement an individual project financing.

Accordingly, whilst purists will continue to point out that the WBNP is not strictly a prohibition on granting security, most market commentators agree that its practical effect is the same.

Breadth of the World Bank Negative Pledge

The WBNP has an extremely broad reach in terms of the entities it regulates and the security which is implicated. To understand which entities are regulated, it is important to understand the key

definition of “Public Assets” in relation to which the relevant government entity agrees not to grant security, without granting the World Bank equal and rateable security. Public Assets” refers to the assets “*. . . of a member, of any political or administrative subdivision thereof and of any entity owned or controlled by, or operating for the account or benefit of, such member or any such subdivision . . .*”.

This phrasing is particularly difficult to construe. One of the difficulties being that the critical phrase “owned or controlled” is not defined. In 1990, the World Bank publicly disclosed a memorandum prepared for its executive directors in which it explained that this definition applies not only to directly held assets but also to assets owned indirectly by subdivisions, departments and instrumentalities of the government. It is clear that the definition also expressly applies to assets held by entities which carry out functions usually carried out by the government. This concept is troubling as the WBNP is then potentially triggered by the operation of certain private side entities under this function-based test. (We return to the concepts of entities being “*owned or controlled*” by the relevant World Bank member within the section below entitled “Tackling the issues”.)

In terms of the security which is implicated, the definition of “*Lien*” is also especially broad in that it covers not only formal security arrangements such as mortgages and charges but it also extends to many types of alternative collateral arrangements because the definition refers to “ . . . privileges and priorities of any kind . . .” (Again, we return to the concept of “*Liens*” within the section below entitled “Tackling the issues”).

Interpretation of the World Bank Negative Pledge

Unfortunately, where a potential transaction is being considered but it comes to light that the WBNP may be triggered, there is a lack of clarity over which laws and rules should govern interpretation of the WBNP. Each time a question arises in relation to whether or not the WBNP may be triggered, legal analysis is first required to determine which rules of interpretation should apply and the answer may depend on all the circumstances of the original World Bank financing, including, precisely which entity is facing the World Bank – a state or government body or some subsidiary or derivative thereof. The matter will also depend upon the terms agreed between the parties – this gives rise to a related issue as the host government may not be willing or able to disclose the underlying documentation for review by sponsors or lenders for reasons of confidentiality or otherwise.

In summary, most commentators conclude that, subject to various fact-specific circumstances, the World Bank’s financing documentation, when used to lend to a host government, is likely to have treaty status under international law and hence the provisions of the Vienna Convention (1986) are likely to prevail which means that, among other requirements, the parties will need to use “good faith” in interpreting the documents and adopt “the ordinary meaning to be given to the terms”.

Of course, it is difficult to predict in which forum these provisions may need to be called into question in the future and it may be open, in particular with respect to local forums in an emerging market should the point arise, for third parties to formulate different rules of interpretation in given circumstances.

Relevant World Bank entities

So far in this article, we have rather loosely referred to the "**World Bank**" but it is worth reflecting on the different organisations that this encompasses, as these may present different consequences for project financings in different jurisdictions.

The International Bank of Reconstructions and Development (**IBRD**) is the world's largest multilateral development bank and lends to so-called "middle-income countries" of which there are approximately 100. These include, to pick just a few of the jurisdictions in Asia which are well known destinations for international project financings or which are being assessed by a number of players for establishing a largely nascent project finance market in Asia, such countries as: Vietnam, Thailand, Sri Lanka, Pakistan, Myanmar and Bangladesh. Earlier on in this article, we saw that the IBRD is most certainly relevant as section 6.02 of its standard financing terms include the WBNP.

The International Development Agency (**IDA**) is the other most relevant entity for these purposes as its standard terms for non-concessional financing also include the same negative pledge provisions as the IBRD. But one of the major differences between these entities is that the IDA also more commonly provides grants and financings on concessional terms which may not include the WBNP. Accordingly, careful due diligence and analysis is required if a government has borrowed from the IDA. Without further verification, it would be wrong to assume that just because a government has only borrowed from the IDA, no WBNP issue exists.

The World Bank Group comprises other entities including the International Finance Corporation (**IFC**) (which focuses on private side investments), Multilateral Investment Guarantee Agency (**MIGA**) and the International Centre for Settlement of Investment Disputes (**ICSID**) (but these entities will generally not be so relevant for purposes of the WBNP.

Tackling the issues

This section of the article attempts to provide guidance on the approach to resolving concerns over the WBNP, including, techniques and avenues to explore, the merit of which will depend upon all the circumstances of a particular transaction.

1. ***Due diligence*** – Effective due diligence is a key part of tackling the WBNP. Unless they have reviewed documentation, legal counsel will strongly preface with disclaimers and health warnings any guidance they are able to provide. Due diligence not only impacts the approach taken to solve problems but also timetable. One of the issues is that many of us have experience of host

governments initially referring to documents containing potential impediments and prohibitions on granting security, only to find that the debts which it had been thought presented difficulties are in a benign form or, perhaps, have already been repaid. Host governments, it seems, frequently find it difficult to confirm which finance documents are current and in place and which debts and other financial obligations are no longer applicable. And when there is certainty, there can be reluctance to disclose copies of sovereign loan agreements, for reasons of confidentiality, and it is often even difficult to obtain redacted versions or excerpts. The bottom line is, in order to have legal counsels provide effective advice, the very least that is required is a confirmation from the host government that the restrictions are current and are in the same form as section 6.02 of the IBRD general conditions.

2. ***Obtaining waivers from the World Bank*** – As with any other contractual situation, theoretically, the World Bank would be able to provide a waiver of the WBNP on a case by case basis. However, realistically this is unlikely to happen in practice. There are examples of where the World Bank has previously provided such waivers but only in very exceptional circumstances. From time to time the World Bank has issued guidance to the sovereign financial community about the types of situations in which they may be willing to provide a waiver but these circumstances have generally been limited to two scenarios only: first, where financial exposure for the World Bank is considered not to be material, and secondly, where the host entity has no financial significance in relation to the ability of the government to repay debt. For most purposes, participants tend to ignore the potential solution of commencing the long and difficult process of trying to obtain a waiver from the World Bank.

3. ***The "purchase money" exception*** – The financing provisions of the IBRD and IDA contain an exemption from the WBNP to allow borrowers to finance the acquisition of new assets which would remain with a borrower after repayment of new debt being raised. Hence, this exemption is usually referred to as the "purchase monies" or "acquisition finance" exemption. The World Bank has previously commented on the rationale for this exception. As the borrower pays down the new debt, the borrower's "equity" in the new debt can be thought of as increasing and hence over time, the World Bank would not be disadvantaged in terms of the creditworthiness and asset base of the entity it is lending to. It is known that there is precedent for this exception applying in the case of loans being raised for the acquisition of ships and aircraft being purchased by member states of the World Bank. But one of the issues with relying on these arrangements in the project finance scenario would be – how would new lenders secure the project's other assets in compliance with the WBNP, such as, to name just a few, the project's accounts, insurances and contracts ? For this reason, it is commonly understood that this exemption by itself will not be helpful in the traditional project finance scenario. But, see below - various projects have investigated employing this exemption as part of a package of work-arounds, in combination with other solutions such as the "local currency borrowing exemption".

4. ***The "ordinary course of banking transaction" exception*** – Another express exemption set out within the IBRD and IDA financing terms provides that security may be provided in support of obligations in foreign exchange *". . . in the ordinary course of banking transactions and securing a debt maturing not more than one year after the date on which it is originally incurred.*" This exception recognises that borrowers will need to continue with their normal day to day short term treasury functions and this is of course generally helpful for sovereign borrowers. But, for most purposes this will not be helpful, or perhaps even relevant, in the infrastructure and project finance scenario – given the limited tenor of debt applicable.

5. ***"Local currency borrowing solutions"*** – As mentioned elsewhere in this article, the WBNP does not seek to regulate local currency debts such that, if the incoming lenders agree to fund all project debt in the applicable local currency, they can safely benefit from a customary project security package without needing to create equal and rateable security in favour of the World Bank. Of course there may be a number of reasons why this does not suit the proposed project financing structure: the financing may simply need foreign sourced financing to satisfy the volume of funds required; project costs and other dynamics may require funding to be in a particular foreign currency such as US dollar (and the local foreign exchange market may be too short term or too expensive to provide an effective hedge between currencies on economic terms). From time to time, parties have investigated structures which would involve having a facility in a local currency (which would benefit from a more traditional project finance collateral package) alongside a facility relying on the "purchase money" exemption referred to above. The proposed structure would involve dividing up the secured obligations so that, those denominated in foreign currency would be secured on the assets to which the "purchase money" exemption would apply, leaving those denominated in the easier local currency to be secured on all other assets of the project company. It is not uncommon to divide and split up obligations and assets in this way – for example, this used to happen routinely within acquisition financings where the former English law "financial assistance" rules meant that certain obligations were not permitted to be secured by certain assets. Nevertheless, the project finance lending market is from time to time relatively inflexible and these kinds of structures can be met with disapproval from syndication desks who beg for structures to be kept simple and in customary form without incorporating such details.

6. ***"Control test" solutions*** – As a reminder, the test for triggering the WBNP using the definition of "*Public Assets*" within section 6.02 of the IBRD general conditions is centred around whether or not an entity is "owned or controlled by" the relevant member country. This is relevant for the critical matter of deciding whether the project vehicle itself is effectively prohibited from granting security. It is notoriously difficult to tie down these concepts with clarity and there are some traps to be aware of such as that all government entities' shareholdings need to be pooled/aggregated for purposes of assessing whether the "owned or controlled" test is triggered. Also, depending on the circumstances, indirect shareholdings may need to be included within the ownership calculations. Note that the World Bank has previously sought to provide guidance on these definitions by clarifying that an aggregate ownership between host government entities of up to 50% of the voting

shares of an entity (but not greater than 50%) should not by itself trigger section 6.02 for the purposes of the project vehicle itself being capable of granting security. But the position would be different if such ownership was greater than 50% or if “control” was given to the government entities by way of contract or by way of them having majority voting power at board level or otherwise pursuant to an entity’s constitutional documents. In such cases, if the project company is owned by greater than 50% of the voting shares, or if it is otherwise controlled by the relevant member state, then the project vehicle would need to rely on one of the other exemptions being applicable in order not to trigger the WBNP. The World Bank has stated that it will consider if the “control and ownership” tests are satisfied on a case by case basis, taking in to account all relevant circumstances.

7. **The “holding company” solution in relation to impediments to granting share security** – As an important rider to the “*control test*” solution referred to above, even if ownership remains at under 50% and there is no control established so that the project company is permitted to grant security without triggering the WBNP, creating security over the shareholding owned by the host government in the project vehicle may still trigger the WBNP. Project finance lenders generally expect to receive security over 100% of the shareholding in the project company so this is potentially a significant problem. One relatively simple solution which has been successfully employed in the past is referred to as the holding company solution. If the government entity agrees to the insertion of a holding company above the project vehicle, a number of other shareholders can participate in this holding company in the same way as if it was a joint venture. The attractive aspect of this from the perspective of the WBNP is that, so long as that vehicle is capable of granting security over 100% of the shares it holds directly in the project company, project finance lenders are less likely to require the government entity to pledge its indirect shareholding in the joint venture holding vehicle. Unfortunately, political factors may arise in that some host governments will not be prepared to agree this arrangement as they may require a direct shareholding in the project company.

8. ***The “switch off” mechanism in relation to impediments to granting share security*** – This article has already described some arrangements which may prevent the WBNP being triggered in respect of asset level security to be granted by the project company. But even if those solutions work effectively, lenders will usually expect security over 100% of shares in the project company and depending on the circumstances there are a number of reasons why the “holding company” solution referred to above may not be feasible or acceptable to the parties. Accordingly, over the years, a number of projects have employed a device which can be put in place in a variety of different ways but which has generally become known as the “*switch off*” mechanism. The aim is to try to put the parties, especially the lenders, into a position which is close to granting them security over all of the shareholdings in the project company, even though it does not require the government entities actually to grant security over their shareholding as that may trigger the WBNP. These arrangements would require the rest of the shareholders – the private side shareholders - to grant customary security over their respective shareholdings. In the case of the government shareholders, they would agree to a mechanism whereby upon enforcement following an event of

default, they will cease to have rights as a shareholder in respect of the project company – as a matter of contract, their rights in respect of such things as dividends and ownership will have been "switched off" until such time as they may be notified by lenders that their rights are no longer switched off. These mechanics would also be replicated within the various constitutional documents of the project company and shareholders. There is also usually a discussion around whether or not the government entities are able or permitted to provide additional support which falls short of granting security but which may assist lenders achieve something closer to customary security over shares in the project company. For example, there may be suggestions that the government shareholders should agree to "drag" or "tag" along rights so as to allow lenders to sell all of the shareholdings in the project company at a time when they enforce against and sell the private side shareholdings – perhaps at a particular discounted price or with an assurance of certain share values to be recompensed to lenders by way of proceeds of enforcement of such shares. Clearly if these additional aspects amount to something akin to a guarantee, it would be expected that this would be rejected by the government entities as it would be outside of the spirit of project financing.

9. ***The "privatisation" solution*** – If an infrastructure project is of sufficient importance, the host government will need to consider if there is scope for taking the drastic step of privatising the relevant government entity which intends owning or controlling the project and the project vehicle. So long as they do not continue to trigger the aspect of the WBNP which refers to an entity operating for "the account of or for the benefit of" the government, privatisation of the entity whereby the government reduces its shareholding in the relevant entity to below 50%, would likely avoid application of the WBNP. Based on explanatory memoranda previously circulated by the World Bank, there is some confusion over the percentage shareholding which the government would need to continue to own or sell down before an entity will cease being considered for the purposes of assessing if it is operating for the "account or benefit of" the government. Part of the commentary of the World Bank implies that an entity may need to be 100% owned by the government in order to be caught by this aspect of the WBNP. However these statements are not necessarily reliable and the market may take a more cautious approach and require the government to own under 50% of the shares in the relevant entity.

10. ***The "trustee borrowing scheme" solution*** – This scheme was developed a number of years ago, in respect of Indonesian financings (but it has also been used in other jurisdictions) to try to get around the WBNP issues. (It also had the advantage of structuring the financing so that key assets, such as receivables, were held offshore which would benefit the integrity and robustness of the collateral package). The arrangement was such that lenders would lend to a borrower which is an offshore entity, as opposed to onshore, and which would act as a trustee and be paid directly by the project's off-taker so as to hold the project revenues on trust for lenders before disbursing them in accordance with a strict waterfall laid down within the project and security documents. This arrangement not only benefits the political risk profile (as key assets are maintained outside of the domestic market) but it also ensures that loan repayments are prioritised ahead of other costs and

expenses. It also meant that the offshore entity was capable of creating security over its rights, outside of the remit of the WBNP. In fact, the regulatory environment in Indonesia is such that the trustee borrower scheme is no longer routinely relied upon as a number of related requirements have become apparent through the changing Indonesian regulations, such as rupiah currency denomination requirements and requirements for certain revenues and payments to need to be filtered back onshore after payment by an off-taker - which give rise either to mandatory forex and hedging transactions, or subject the mechanism to theoretical circularity and payment risk as funds must derive from, but then be repatriated to, onshore bank accounts, albeit temporarily. In short, projects are still considering variations of the trustee borrowing scheme but subject to a number of adaptations to take account of the changing local regulatory scene.

11. ***Lender liability*** – It is conceivable that third parties will attract liability in tort for inducing a breach of contract by another party. Always in the background is the spectre for lenders and their external and in-house counsels that once it is known that the WBNP exists, there may be the potential for some kind of tortious liability to attract to lenders with respect to causing a host government to contravene its contractual obligations to the World Bank. In fact, establishing liability and damage in these types of matters is not straightforward and yet incoming banks will usually take a cautious approach to working around the WBNP, once their counsels have informed them of this type of potential liability. There is always potential for lenders attracting reputational damage which may feature just as importantly for those assessing risk and control within the bank as well as for internal compliance generally.

12. ***Other consequences of contravention*** – If the World Bank considers that the provisions of its finance documents have been breached, in theory it may be able to raise various contractual claims and seek damages and other remedies against host government entities. The World Bank has said that in this situation its rights and remedies may include deciding not to put forward for approval by its board any new or additional proposed financings being considered for any government which is in breach. It may also suspend disbursements on its existing financial commitments to such borrowers. Clearly these consequences may trigger cross defaults with other sovereign financings and commitments. All of these consequences are potentially serious and experience shows that host governments consequentally take a cautious approach in dealing with the WBNP.

13. ***Approach of project finance lenders*** – Finally, we would flag a general point that the WBNP requires all parties to keep an open mind in trying to create a bankable and robust collateral package which is sufficiently standard to appeal to the syndications market but which does not risk offending the terms of the WBNP. Over the years, we have found it helpful for lenders to sit with their legal counsel and reflect on the true role and significance of aspects of the collateral package, including various remedies and enforcement scenarios, so that they can then visualise where they may be able to be more flexible than they might otherwise have thought. By way of example, many emerging market jurisdictions have local laws which are already not especially friendly or respectful to the rights of international lenders. For this reason, the project's collateral arrangements may

have already ensured that many of the project's assets, including revenue streams, have been diverted offshore and that much of the onshore package effectively lives on only as "defensive security" whose main aim is to ensure that assets are not attached by other creditors or commingled with other assets but which is not realistically considered as giving rise to classical remedies such as an effective right of sale. If this is the case, lenders may take comfort in insisting on their own extensive negative pledge which may achieve some elements of the "defensive security" approach and all parties should consider if any alternative security or security structures are available depending on the circumstances of the transaction, including limited, additional credit enhancement or sponsor support.

Conclusions

As the infrastructure markets begin to recover, focus is bound to turn again to the impediments brought about by the lending terms of the World Bank.

In particular, the notorious negative pledge clause is likely to continue to create difficulties for raising project finance debt in certain emerging markets.

As this article shows, a number of different exceptions, solutions and workarounds may be employed to attempt to solve these issues but when tackling the World Bank Negative Pledge, all project participants will need to show flexibility, patience and a degree of innovation.

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[1]This provision and its embedded definitions are complex and, whilst some aspects are considered in this article, a full examination of this provision and the consequences which arise from it are outside the scope of this article.

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