# Agreements, bonds and guarantees

## SPV Formation

The Special Project Vehicle (SPV) may take a variety of forms, including a corporation, limited liability company, general partnership, limited partnership, or joint venture arrangement. However, the relevant jurisdiction's company law will need to be examined in order to determine the feasibility of each type of structure for the SPV. Such laws may, for example, set special financial, technical or business requirements for shareholders, mandatory capitalization ratios or required statements of purpose. A Shareholders Agreement (or form of partnership or other agreement as the case may be) will set forth the respective rights and obligations of the owners of the SPV.

## Shareholders Agreement

The shareholders agreement sets forth the rights and responsibilities of each entity in the project company that has been granted the concession to design, build, finance, or operate the toll road. The issues to consider when drafting the shareholders agreement are little different from those of any business organization: One must first decide whether the entity will be a corporation or partnership (or, in some jurisdictions, a limited liability company, which has characteristics of both) and then determine the relative rights and responsibilities each shareholder will have with respect to capital contributions, transfers, conflicts of interest, and restrictions on competition. In many cases the parties to the shareholders agreement will be constrained by the concession contract or the lenders to a project with respect to each of these issues.

In most cases that concessionaire is a special purpose vehicle ("SPV") or a joint venture among the companies that will be responsible for carrying out the concession. Thus there exists an inherent conflict of interest between the shareholders as project company owners and their separate interests as owners of the contractors and operators of the road. To mitigate this conflict, the shareholders agreement often contains provisions designed to limit shareholders' power to vote on contracts in which they would be involved, to keep contractors involved until a project is completed, and to ensure that the credit worthiness of the financial backers is maintained.

The following key terms are often utilized in project finance shareholders agreements:

**Conflict of interest clauses** may require super majorities for decisions that would clearly benefit one or more shareholders such that the interested parties' votes alone could not determine the outcome of that particular vote.

**Pre-emption rights** are often used to ensure that the original participants remain involved until key milestones in development are achieved. A standard pre-emption provision would state that a shareholder wishing to transfer its shares to a third party before a certain milestone has been achieved must first offer its shares to the remaining shareholders at a fair market price.

**Non competition clauses** seek to ensure that the shareholders remain committed to the project and may require that shareholders not participate in any competing ventures or otherwise undermine the purposes of the project. However, such provisions must take into account the relevant jurisdiction's competition laws.

**Capital contribution provisions** also help to ensure that participants remain fully committed to a project and to ensure the Sponsor remains financially viable - an important concern of both the government granting the concession and the outside lenders. While contingent capital contributions are common, whereby a shareholder is not required to commit its equity subscription until it is needed, often times shareholders will be required by the lenders to obtain a letter of credit or payment guarantee as a condition of becoming a shareholder. Shareholders agreements may also provide for additional loan commitments beyond the equity subscription amounts. Some shareholders - usually local entities in developing countries that lack financial capital - may be allowed to contribute its capital in kind, such as by donating land or services to the project. However, special attention must be paid to ensuring a fair valuation of such contributions.

**Governance provisions** set forth the relative powers of different shareholders and, as mentioned in the Conflict of Interest section above, often segregate issues that must be decided unanimously, by super majority, or a simple majority vote according to their importance to the project. Sometimes the shareholders agreement will assign to certain parties primary responsibility for decisions on subject matters in which it has particular expertise.

**Deadlock provisions** are also important for setting forth the procedure for resolving disputes when unanimity is required and the shareholders cannot agree. They may include obligations to reach a consensus among the board or among the heads of the participating shareholders and, failing that, by outside arbitration.

## Loan Agreements

Many PPP projects in the road sector require funds to be provided from several sources. Most large PPPs that include project financing will have a mixture of debt and equity with different classes of share capital and several layers of debt. A large toll road may require loans not only from commercial banks but also from one or more multilateral or export credit agencies, whose loan maturities will likely be longer than those from commercial banks. In addition, some of the lenders may be subordinated to others, some may be secured while others not (such as banks providing only working capital), and therefore lenders will want to ensure their position among other lenders is clear throughout the project through an intercreditor agreement. Intercreditor agreements address issues such as whether all of the levels of lenders have to agree before any of them can accelerate their loans or take enforcement action against the project.

### Lenders Rights

Refer to the Insolvency and security Laws section under the Legislative Framework.

**The Infrastructure and Law website** of the World Bank presents useful information under Lender Issues.

Infrastructure and Law website (UserID and password required; refer "Create account" for free access)
http://web.worldbank.org/external/default/secmain?theSitePK=4817374&pagePK=4710368&contentMDK=21759230&menuPK=5099523&piPK=64860384#sample

The World Bank has coordinated efforts to produce standards regarding insolvency and creditors rights. This information can be found on the World Bank Global Insolvency Law Database under Principles and Guidelines.

http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/0,,pagePK:181022~theSitePK:215006,00.html

The two main concerns for the project lenders in any given project finance transaction are to (i) ensure that they will take effective security over most, if not all, assets of the project (including the shares of the project company, the project revenue contracts through the assignment of receivables, the rights of the project company in connection with the project agreements and the tangible and intangible personal property of the project company), and (ii) to be able to take control of the project as soon as possible in case the project encounters financial difficulties (sometimes called "step-in rights").

**Right to security interest in project assets.** Generally, the project company will be prohibited from transferring or assigning any of the project's assets, agreements or rights and obligations to third parties without the prior consent of the host government. At the same time, however, it is essential for the project company to have the power to give lenders a security interest in the assets, agreements and rights and obligations of the project for purposes of and in exchange for receiving adequate project financing.

The host government and project company, therefore, must permit the lenders all the security interests which may be necessary for purposes of financing the project (i.e., in order to achieve the "bankability" of the project). In addition, the host government must ensure that its legal framework is conducive to the effective creation and enforcement of security interests in connection with debt obligations, without which a project financing structure will not be possible.

**Substitution or Step-in rights.** The host government typically is requested to (i) grant lenders the right to "step into" the project company's rights and obligations in case of a project company default under the project agreements and (ii) to acknowledge the right of lenders to "step in" for the project company in case of a default under the financing agreements. The lenders, pursuant to these "step-in rights", generally have an opportunity to cure any default under the project agreements and may substitute an entity of their choice for the project company (subject to meeting certain criteria related to the performance capability of such third party in further developing, operating or managing the project).

## Guarantees

Guarantees are generally provided to lenders, to be used for financing infrastructure, where the demand for funding is large and involves the private sector, political and sovereign risks are significant, and long-maturity financing is critical to a project viability, as it is the case with roads, where the completion period is long and the cost recovery period extends from 5 to 15 years.

By covering risks that the market is not able to bear or assess adequately, guarantees may reduce financing costs, attract additional sources of financing and extend maturities. The guarantees are most valuable where activities traditionally undertaken and financed by the government are being shifted to the private sector, but where the government and its agencies remain involved.

Guarantees provided by the Government to make the project more attractive to private actors are described in Module 3 -> PPP Policy Framework -> Financial Framework.

When the guarantees are provided by an international financial institution such as the World Bank, the participation of the guarantor can facilitate transactions. An institution like the World Bank may provide either a partial risk guarantee or a partial credit guarantee.

A partial risk guarantee ensures payment in the case of debt service default arising from non-performance of sovereign contractual obligations or certain political force majeure events. This type of guarantee is appropriate for private projects, especially for "limited-recourse financing", as in build-operate-transfer, build-own-operate and similar concession projects. Transfer risks may also arise for investors and lenders because of constraints in the availability of foreign exchange, such as procedural delays on the part of the government or adverse changes in exchange control laws or regulations, and the partial risk guarantee will cover these as well.

A partial credit guarantee typically extends maturities beyond what private creditors could otherwise provide, for example by guaranteeing late-dated repayments or providing incentives for lenders to roll over short-term loans. They are typically used for public projects involving sovereign borrowing. The need for such guarantees arises if short-term financing (for the construction period, for example) is available, but the prospects of rolling over such financing are uncertain. The goal is to stretch credit term beyond what the lenders might otherwise agree to.

### Counter-guarantee

The World Bank will require a counter-guarantee from the project's host country government in accordance with the Bank's Articles of Agreement. The counter-guarantee of the government to the World Bank is provided through an indemnity agreement, whereby the government indemnifies the World Bank for any payments made by the World Bank under its guarantee.

The government's counter-guarantee usually counts against the yearly spending budget and in most countries requires a legislative act.

In the context of construction completion, generally related to the Construction Agreement, both the Contracting authority and the lenders will require a construction completion guarantee, which will usually take the form of a written commitment backed by some consideration and issued by the construction company prior to closing. This guarantee is aimed at shifting the completion risk away from the Concession Grantor and the lenders and towards the construction company, which in turn will favor the entire project.

## Bonds

Performance, bid, warranty and payment bonds are credit enhancement mechanisms used to support a contractor's financial obligations under a contract. Under this structure a third party, usually a bank, will issue the bond guaranteeing payment to a beneficiary if the bonded party fails to perform the contract. Construction contractors are usually obligated to put up a performance bond based on a percentage of the contract price.

They may also be required to put up a bid bond to support their obligations prior to the award of a contract. Warranty bonds support the obligations of a contractor to perform ongoing maintenance operations. Payment bonds are issued to a project company to ensure a contractor meets its payment obligations under a contract, such as to pay liquidated damages upon delays in completion.

In each case, failure to perform the conditions of a contract will trigger the surety that issued the bond to fulfill the contractual obligations up to the amount of the bond. The project lenders will also generally be assigned rights to the bond as part of the collateral for a project loan.