Andreea
Cărare
see profile

THE PRIVATE PROJECT FINANCE OF PUBLIC PROJECTS. AN OVERVIEW ON SECURITIES

In 2016, the Romanian legislation in the field of public projects underwent a complex reform. New public procurement, public-private partnerships and concessions enactments entered into force as a result of the European Union Directives adopted in 2014 being transposed into the national legislation. Following such developments, the legislation of works and services concessions and of public-private partnership suffered also significant changes in terms of the private financing of public projects. These changes impact particularly the securities under the finance projects and the potential benefits that a financer might enjoy under a concession or public-private partnership.

1. PRELIMINARY CONSIDERATIONS ON THE PROJECT FINANCE OF PUBLIC PROJECTS

CONCESSIONS

The Romanian legislation contains only very brief specific references in terms of private project finance of concessions given that the economic risks pertaining to the operation of the project must be borne by the concessionaire. The legal regime applicable to such financing agreements derives mainly from the legal framework set by the general provisions regulating loan agreements, concessions and public ownership right.

The new concessions legislation establishes a general obligation of the contracting authorities to elaborate the payment mechanism in a way ensuring the bankability of the project. Also, Law no. 100/2016 on the concession of works and services brings into discussion a new concept in the Romanian concession legislation – namely the "financial closure", setting forth that this represents the moment when the concessionaire concludes the financing agreements with the financing institutions, in view of obtaining the financial resources necessary for performing the awarded concession. Despite the reference made to this concept, no further provisions regarding the financial closure are included in the concessions legislation. The concept is however important, with significant practical impact from at least two perspectives: (i) on one hand, the involvement of the financing institution throughout the whole process of bid submitting and execution of the concession agreement

is mandatory in order to enhance the success of the financing project to the highest possible extent; and (ii) on the other hand, the financial closure is usually a suspensive condition in the concession agreement to be fulfilled until a certain long stop date.

PUBLIC PRIVATE PARTNERSHIP

Given that the public-private partnership law is applicable to projects in which the incomes are generated mainly through availability payments made by the public partner, the new public-private partnership legislation is more detailed in terms of private financing of the project. In this respect, the PPP law sets forth that the private investor provides the necessary financing of the project from its own resources and/ or from resources of financers. The assessment study elaborated by the public partner has to address the financial eligibility of the project, this being analysed from the perspective of the technical, financial and legal features of the project – the structure of these factors gives the project the perspectives on the granting of credits/ allocation of financial resources in order to finance the project throughout its entire existence.

Although the two relevant enactments address the concept of bankability/ financial eligibility in different wording, the PPP law gives not only a general guideline as regards the factors to be considered in analysing this feature of the project, but also more detailed provisions on the possibility of establishing securities, as described here below.

2. SECURITIES FOR FINANCERS

The financing obligations of a private investor related to a public investment project are in practice subject to complex securities mechanisms. The matter of these securities systems becomes even more complex in case of SPVs, considering the limited scope of these companies and that their financing eligibility is often assessed based on the financial standing of the parent companies.

We have addressed only some of the types of securities for financers.

2.1. MORTGAGE ON INCOMES

The most important form of guarantee established in favour of the financers, in relation to a concession agreement, is the mortgage on the accounts since the main source of revenue for the reimbursement of the loans comes from the incomes of the concessionaire, especially the ones resulting from operating

the concession.

In this respect, the PPP law expressly sets forth that the private investor/ the SPV can establish guarantees regarding the receivables and the rights held under the public-private partnership agreement. The securities can be established solely in favour of the financers (i.e. credit institutions or financial institutions) and only during the existence of the corresponding public-private partnership agreement. An observation that needs to be made and that is equally valid for the case of the mortgage on the shares of the SPV established under a public-private partnership is that the agreement has to include references to the conditions in which such securities shall be transferred or terminated in case the agreement ceases prior to the expiry date.

Nonetheless, the incomes do not include solely the revenues deriving from the

performance of the agreements and from operating the projects developed under the concession or the public-private partnership. Such revenues may also consist of damages to which the concessionaire or the private partner is entitled to under the agreement. Thus, from this perspective, the contractual provisions regarding the right of the concessionaire or of the private partner to such damages, as in case of early termination by the public entity, represents in itself a form of guarantee that the financer may benefit of.

2.2. MORTGAGE ON SHARES

The concessions legislation does not include an interdiction to encumber, nor to assign the shares of the concessionaire. Thus, a mortgage over the shares of such concessionaire can be established in all cases.

The European Court of Justice issued a judgement with respect to the matter as to whether a change of the shareholding structure of the concessionaire

(e.g. by enforcement of a mortgage) represents a material change of the concession agreement and upheld that public agreements are regularly awarded to legal entities. Any changes to the composition of the shareholders in such a legal entity will not, as a rule, result in a material contractual amendment. Nonetheless, under the same judgement, it is stated that the transfer of shares to a third party (e.g. outside the group) does not fall under the purpose of an internal reorganisation of the initial contractual partner, but it is an actual change of such contractual partner, which would, as a rule, be an amendment to an essential term of the contract.

Thus, the shares of the concessionaire may be encumbered in favour of a financer and assigned to third parties, but it is highly recommendable and usual in practice, for encumbrances to be established/ transfers to operate solely with the prior approval of the contracting authority and by providing (in the tender documentation and concession agreement) the specific conditions under which it may operate. With respect to such specific conditions, they may consist, for example, in provisions granting the right of a shareholder to assign its shares only after it has fulfilled its obligations under the concession. It is thus recommendable for the tender documentation and the agreement to include clear provisions on the possibility of changing the shareholding structure and to provide express conditions on the financial standing of the potential acquirer in case the capacity of the initial shareholder was essential in the initial procedure.

In all cases, the change of the shareholding structure, irrespective of whether it is made due to enforcement of encumbrances or by transfer to third parties, has to be made without affecting the rights and guarantees of the contracting authority under the concession agreement and without substantially altering the concession.

As regards the public-private partnership, the law includes a specific reference to this matter and sets forth that the private investor can establish guarantees on the shares held in the SPV exclusively in favour of the financers (i.e. credit institutions or financial institutions) and only during the existence of the corresponding public-private partnership agreement.

In both the above cases, the assignment of shares can be regulated in the review clause of the concession/ public-private partnership agreement (and in the collateral instruments) as a mechanism to enforce a step-in right of the financers.

Although the mortgage on the shares of a limited liability company is, in practice, a widely used type of security, its enforcement is difficult to be achieved, due to both practical and legal considerations pertaining to procedures to be carried out with the Trade Registry which are by nature consensual. Thus, from a practical standpoint, the rights of the financer deriving from the mortgage over the shares can be valued rather under a consensual procedure of shares assignment, performed with the observation of the abovementioned conditions.

2.3. STEP-IN RIGHT

The new legislation of the concessions and of public-private partnership sets forth a specific type of remedy, also a form of security for the financers, in case the initial concessionaire/ private investor fails to fulfil its obligations under the concession. In such case, the financer is entitled to step in the concession and to assign the agreement to a new economic operator, provided that it fulfils the qualification and selection criteria established in the initial award documentation.

As regards the public-private partnership, the choice of the private partner by the public one can be made solely upon consultation with the financer. Should the public partner fail to conclude the agreement with the new private partner, the former shall be entitled to terminate the relevant public-private partnership agreement. Thus, although both the concessions and public-private partnership legislation provide the right of the contracting authority/ public partner to change the concessionaire/ private partner, in the latter case the legislation is more specific by expressly requiring the approval of the financer in this respect. Although, such obligation is not expressly regulated in the concessions legislation, from a practical standpoint, the necessity of obtaining this approval might be inserted in the corresponding review clause and necessary as a matter of practice.

For the step-in right to operate, the following conditions have to be met:

2.3.1. Existence of a review clause regarding the step-in right in the agreement

The review clause has to be clear, precise and unequivocal. The amendment can refer to a matter evaluable in money or not and it can be performed irrespective of its value. Also, the review clause has to include the scope, limits and nature of the envisaged amendments or options, as well as the conditions under which it operates. Nonetheless, the review clause cannot refer under any circumstances to matters altering the overall nature of the agreement.

Additionally, the replacing mechanism shall be inserted in a separate agreement, called a direct agreement, concluded between the three parties: contracting authority/ public partner, concessionaire/ private partner and financer. By this direct agreement, the parties agree that, in case the concessionaire/ private partner falls below certain reference indicators, the financer may step in the agreement and is entitled to change the initial concessionaire/ private investor. The public authorities have very limited expertise in the field of concluding such direct agreements, as such concept is also newly enacted.

The replacement of the initial concessionaire/ private investor has to occur exclusively due to non-discretionary, exterior circumstances which were established from the very beginning, known and acknowledged by all parties and does not have to represent in any way a discretionary right of the public entity to replace it during the performance of the concession agreement.

2.3.2. The new concessionaire/ private investor has to meet all qualification and selection criteria in the initial documentation

This condition has to be observed by the new concessionaire/ private investor, irrespective of whether it was actually a participant in the initial public procedure or not. The main criteria is its abstract capacity of having successfully participated in the initial public procedure, by meeting the qualification and selection criteria.

2.4. JOINT LIABILITY WITH THIRD PARTIES

In case of SPVs acting as concessionaires/ private investors, it is the financial standing of the parent companies that significantly influences the financing eligibility of such SPV.

Nonetheless, under normal circumstances, the shareholders of a limited liability company only bear a limited recourse liability as form of guarantee towards third parties – i.e. limited to their contribution to the share capital of the company.

In addition to this limited recourse guarantee, if acceptable for the financers,

the parent companies, which actually have the financial capacity under the concession, can establish either an autonomous security or a guarantee consisting in the joint guarantee with the concessionaire/ private investor. With respect to the conditions which have to be observed by the guarantor granting such security, the Civil Code sets forth that it has to be a person having full capacity, residing in Romania and holding in Romania sufficient assets in order to satisfy the debt of the main debtor. Nonetheless, should the creditor (i.e. the financer) request for a specific person to act as joint guarantor, the aforementioned conditions are no longer mandatory.

2.5. MORTGAGE ON ASSETS

With respect to the analysis of the encumbrances that can be established and the securities which can be granted in relation to the assets, part of the concession, the general principle in the field of the public ownership right under Art. 861 of the Civil Code has to be taken into account: the assets subject to the public ownership right are inalienable (i.e. the ownership right cannot be transferred), intangible (i.e. cannot be encumbered and be subject to foreclosure) and are not subject to acquisitive prescription (i.e. the ownership right cannot be acquired by elapse of time and operation of ususcapio).

Moreover, Art. 872 para. (1) of the Civil Code provides that no encumbrance can be established in relation to the assets subject to the concession right, used or resulting from the concession.

Thus, no encumbrances (e.g. mortgages) can be granted in relation to any assets to be returned to the contracting authority (i.e. the assets which represent the scope of the concession, the assets used during the concession and the assets resulting from the concession - namely the investments carried out by the concessionaire for the performance of the works concession agreement), such encumbering deed being null and void.

As regards the assets to be returned to the contracting authority at the termination of the concession, which are subject to the private ownership right of the Romanian State/ the administrative territorial units, theoretically, they could be encumbered during the concession, with the prior approval of the contracting authority (to be mentioned in the tender book and in the concession agreement). This would equal a partial transfer of the risks from

the concessionaire to the contracting authority. Nonetheless, the obligation to return these assets free of encumbrances at the end of the concession remains in force. Thus, the concessionaire would have to return them as received or by equivalent. From a practical standpoint, this is not an efficient type of security – on the one hand, the financial reliability for the financer would be rather remote and, on the other hand, obtaining the approval of the contracting authority for encumbering this assets is quite improbable.

In relation to the same matter, in the field of the public-private partnership, the law sets forth that the private partner or, as the case may be, the SPV established under the project, cannot establish a concession right over the assets, services or the works received in concession.

As regards the self-procured assets involved in the concession/ public-private partnership, these are subject to the private ownership right (or another real or use right) of the investor and are used during the concession/ public-private agreement for the performance thereof. These assets are and remain owned (or otherwise held or used) by the concessionaire/ private investor throughout the agreement and upon termination thereof. Thus, such self-procured assets can be encumbered by the concessionaire/ private investor, subject to the observance of the general legal provisions, as security for the reimbursement of loans.

Considering all the above, the current legislation in the field of public-private partnership and concessions has created the necessary legal framework in terms of project finance of public project. The law establishes, however, only the grounds and the main rules in the field. The efficiency of these new mechanisms depends hereafter mainly on the public authorities having prerogatives in the field, on the interpretation that they shall give to these legal institutions and on the practical instruments that they shall create for their implementation.

Also, the above analysis shows that the securities that can be granted to financers are almost similar in case of concessions and public-private partnership. The advantage in the latter situation is that it sets forth a clearer frame for these securities mechanism, while in case of concessions, the legal regime of the guarantees that can be established derives mainly from the general rules of civil and administrative law in the field of concessions and encumbrances.