SITUATING PROJECT FINANCE AND SECURITIZATION IN CONTEXT

A COMMENT ON BJERRE

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Carl Bjerre has written an interesting analysis of some overlapping legal issues in project finance and securitization transactions. However, some of his reasoning and conclusions do not reflect the broader environment in which these transactions are carried out.

Project finance generally results in the creation of a new cash-flow producing asset. Because this asset is created not in the originator but in the special purpose vehicle (SPV), no true sale is required. Consequently, project financings are safer from interference in the case of an originator bankruptcy and are less sensitive to originator recourse. Indeed, project financings are typically non-recourse to the originator. Further, in a project finance transaction there is no risk of the financing being recategorized as a secured loan on the balance sheet of the originator, which would result in increased leverage on its balance sheet. Although project finance has structural aspects that provide definite advantages over traditional structured finance, these differences pose problems of their own. Specifically, the opportunities for a project finance SPV bankruptcy are substantially greater than the typically passive SPV designed for structured finance transactions. When an SPV is operating an asset, and the asset is a dangerous or controversial one, there is an increased chance of adverse financial consequences. Project finance receivables generally (but not always) flow from a small number of obligors. These factors introduce greater credit risk than is normally found in structured finance securitizations, which typically consist of receivables from a statistically predictable large pool.

Professor Bjerre's comparison and contrast of project financing and securitization is somewhat effective, but he abruptly moves into a

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wholly unrelated discussion of consensuality with respect to the adverse impact that project financed transactions may have on third parties.[1] Since project finance mechanisms typically result in the creation of a new asset such as a large infrastructure project, there are frequently broad social and political ramifications that are absent from most structured financings. Third parties are affected by the project operations. This leads Professor Bjerre to his main argument: that consensuality is only present in varying degrees in project finance transactions.[2] In other words, many third parties do not consent to the project, but are greatly impacted by it nonetheless. Structured finance also struggles with this issue, but on the level of unsecured creditors of the originator wanting fair compensation for the transfer of receivables.

Professor Bjerre's article would be more effective by comparing and contrasting basic structuring issues in securitization and project finance. It is debatable whether a law review article in a symposium issue on securitization should ruminate about erecting "a philosophical framework within which to judge the acceptability" of the tradeoffs between economic benefits and social costs involved in large projects.[3] Professor Bjerre wants to connect the "discourses" of human rights law, sociology, and developmental economics with project finance. This is a fine thought in the abstract, but he misses the mark. The developmental concerns Professor Bjerre raises are important ones. However, I fail to see the relevance to other parts of the article. Professor Bjerre seems to conflate issues of project financing techniques with the societal effects of project finance. Professor Bjerre should critique not the social and political aspects of project finance, but rather the regulatory structure governing large-scale investments in general. There is nothing unique to project finance in this regard. The same power plant can be financed through project financing techniques, through direct foreign equity investments, or by local governments from tax revenues. Project finance is only one of several financial means to accomplish the same result.

The argument that project finance has negative effects on third parties ignores the fact that the large majority of such projects are based upon government concessions, which by their very nature are intended to be in the public interest. Public concessions resulting in

1. Carl S. Bjerre, *Project Finance, Securitization and Consensuality*, 12 DUKE J. COMP. & INT'L L. 411, 424 (2002).

2. *Id.* at 427–9, 434–36.

3. *Id.* at 435.

negative effects on select populations are not a concern of project finance and securitization (by which I mean the financing aspects), but of political theory and democracy. Professor Bjerre states that such projects are "imposed against the will of much of [the] public."[4] From the perspective of third parties, there is nothing unique to building power and transportation projects in emerging markets, as opposed to shopping malls, industrial complexes or office buildings in the United States, through conventional corporate financing. Third parties may consent or object to business activities occurring in society, but they are all regulated by the government. This is not a unique problem of project financing, and indeed these same negative effects can occur as a result of a securitization, which can provide specific funding methods for corporations to expand their operations, such as to construct additional office buildings or industrial complexes.

Professor Bjerre's use of the terms "specialness" and "agglutination" merit further exploration.[5] Combining project finance and securitization approaches to the same transaction is a valuable area of discussion.[6] Professor Bjerre suggests that a project finance SPV could securitize its receivables through a bankruptcy remote true sale to another SPV. This suggestion, however, has substantial limitations, which may restrict the utility of such securitizations. Professor Bjerre does not fully recognize the costs and effects that securitizing such an entity would have on the overall transaction (other than saying that it would be very costly). The substantial additional time needed to close a project financed SPV and then securitize its revenue stream is a considerable cost, with comparably few benefits to the project sponsors. Project financings are enormous transactions with extraordinary legal fees designed primarily to remove risks to the ultimate parent, although many such transactions have limited recourse to the sponsors through the project completion date and, to some extent, for off-take arrangements. There are limited incentives for that parent to expend additional fees and resources to accomplish bankruptcy remoteness at its own project-SPV level, and there is little to gain from those increased costs initially.

Securitization of a project finance transaction most likely would occur several years after the project is completed and operating at full capacity. Even then, the international securitization potential would be very limited, since the receivables to be securitized are generally

4. *Id.* at 434.
5. *Id.* at 419.
6. *Id.* at 411, 421–23.

denominated in local currency, exposing the purchaser of SPV securities to devaluation risks. In addition, while assets like toll roads may have a large number of diversified revenue generators, many project finance transactions have substantial off-take arrangements with a very limited number of governmental entities without much verifiable default history. To the extent emerging markets modify their legal structures to permit true sale and bankruptcy remoteness, local asset securitizations have the potential to assist the development of national bond markets and thereby contribute to capital market development.

Professor Bjerre's analysis of the potential for securitizing project financed SPVs is a useful and important contribution, and is worthy of further exploration. While such securitizations have been occurring over the last several years, they are uncommon, and there may be unexplored efficiencies in utilizing this type of transaction.