

СУЧАСНА СИСТЕМА МІЖНАРОДНОГО ПРАВА

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LEGAL MECHANISMS OF MINIMIZATION OF PROJECT RISKS ARISING WITHIN INTERNATIONAL PROJECT FINANCE

ПРАВОВІ МЕХАНІЗМИ МІНІМІЗАЦІЇ ПРОЕКТНИХ РИЗИКІВ, ЩО ВИНИКАЮТЬ В РАМКАХ МІЖНАРОДНОГО ПРОЕКТНОГО ФІНАНСУВАННЯ

ПРАВОВЫЕ МЕХАНИЗМЫ МИНИМИЗАЦИИ ПРОЕКТНЫХ РИСКОВ, ВОЗНИКАЮЩИХ В РАМКАХ МЕЖДУНАРОДНОГО ПРОЕКТНОГО ФИНАНСИРОВАНИЯ

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Abstract. *This article examines, classifies and categorizes various types of project risks inherent to international project finance and discusses legal techniques employed by the key participants of project finance to mitigate each of these risks based on thorough examination of project documentation typically elaborated for this purpose. It covers both commercial (internal and external) and non-commercial risks, in particular, completion risk, risk of excess expenditure, operational risk, environmental risk, risk of insufficient revenues, supply risk, currency risk, inflation risk, interest rate risk and others. The author argues that non-commercial risks, including political or country risks, present even greater peril for an international project and offers a complex of protective legal measures which could be used for diminishing such risks in the long run. The conclusions formulated at the end of the article present the author's personal attitude towards legal solution of the problem of minimization of the project risks arising within international project finance.*

Key words: *project finance, project company, commercial risks, non-commercial risks, contractual remedies.*

Анотація. *У цій статті досліджуються та класифікуються різноманітні види проектних ризиків, які притаманні міжнародному проектному фінансуванню, та вивчаються юридичні інструменти, які застосовуються ключовими учасниками проектної фінансування для мінімізації кожного з цих ризиків, на основі вивчення проектної документації, що розробляється для цієї мети. У статті аналізуються як комерційні (внутрішні та зовнішні), так і некомерційні ризики, зокрема, ризик незавершеності проекту,*

ризик перевищення кошторису проекту, операційний ризик, ризик заподіяння шкоди навколишньому природному середовищу, ризик недостатнього обсягу доходів, що генеруються проектом після його завершення, валютний ризик, інфляційний ризик, ризик несприятливих змін у ціновій кон'юнктурі чи розмірі відсоткових ставок та інші. Автор наголошує на тому, що некомерційні ризики, включаючи політичний ризик, становлять ще більшу загрозу для реалізації міжнародного проекту, та пропонує комплекс захисних правових заходів, які можна застосовувати для зменшення таких ризиків у тривалій перспективі. Висновки, сформульовані наприкінці статті, представляють авторську позицію стосовно розв'язання проблеми мінімізації проектних ризиків, що виникають в рамках міжнародного проектного фінансування, за допомогою правового інструментарію.

Ключові слова: проектне фінансування, проектна компанія, комерційні ризики, некомерційні ризики, договірні засоби правового захисту.

Аннотація. В данной статье исследуются и классифицируются различные виды проектных рисков, которые свойственны проектному финансированию, и изучаются юридические инструменты, которые применяются ключевыми участниками проектного финансирования для минимизации каждого из этих рисков, на основе изучения проектной документации, разрабатываемой с этой целью. В статье анализируются как коммерческие (внутренние и внешние), так и некоммерческие риски, в частности, риск незавершенности проекта, риск превышения бюджета проекта, операционный риск, риск причинения вреда окружающей среде, риск недостаточного объема доходов, генерируемых проектом после его завершения, валютный риск, инфляционный риск, риск неблагоприятных изменений в ценовой конъюнктуре или размере процентных ставок и другие. Автор подчеркивает, что некоммерческие риски, включая политический риск, представляют собой еще большую угрозу для реализации международного проекта, и предлагает комплекс защитных правовых мер, которые можно применять для уменьшения таких рисков в длительной перспективе. Выводы, сформулированные в конце статьи, представляют авторскую позицию касательно разрешения проблемы минимизации проектных рисков, возникающих в рамках международного проектного финансирования, при помощи правового инструментария.

Ключевые слова: проектное финансирование, проектная компания, коммерческие риски, некоммерческие риски, договорные средства правовой защиты.

General statement of problem. Project finance presents a method of raising long-term finance exclusively for the specified project. Under this scheme the banks shall provide loans specifically for the project implementation, and these loans shall be repaid solely by the cash-flow generated by the project. Thus, the lenders take the most part of the risk of success or failure of the project. The success of the project finance over the last decades has been largely driven by the fact of internationalisation of the investment markets and desire of the national governments to shift the burden of financing of public-sector projects to the private investors. This is especially significant for Ukraine where public and private partnership, despite availability of applicable law, remains insufficiently developed.

The basic structure of project finance involves establishment of a special purpose vehicle company created exclusively for the purpose of running the project and traditionally called the 'project company'. The predominant part of funding for the project is provided by the lenders (usually a syndicate of international banks) which enter into the loan agreement with the project company acting as the borrower to finance the project. Since the project company running only the business related to the project has no sufficient assets to secure the whole amount of debt finance or credit history, lenders shall rely only on the future cash-flow to be generated by the project. Taking into account that the project company has no business record or credit history, the lenders' decision to advance funds is based solely on a projection of future cash flow from the project which is not yet completed, and this fact gives rise to the uniqueness of the risks taken by the creditors funding the project.

Project finance is inextricably connected with significant risks, which should be painstakingly identified, qualified and scrupulously assessed with due advance in order to respond to various detrimental scenarios. Unlike other forms of financing, project finance is a long-term business, extremely vulnerable to different exposures non-relevant to traditional credit transactions. In order to avoid subsequent disputes and cumbersome negotiations, identified risks should be carefully allocated between different groups of participants in the project, and this sharing of risks should ultimately be reflected in the project documentation. Adequate allocation of a risk to a particular party in the project should imply that this party is able to control and manage this risk and that it has enough resources to face that risk if it occurs. The project documentation should also envisage mitigation of the risks to the maximum extent possible. These reasons determine high significance of our present investigation of the project risks and suitable legal instruments and techniques of their elimination within international project finance.

Recent researches and publications. In international scholar community problems related to project risks were adequately highlighted by J. Delmon in its Ph.D thesis '*Increasing the Efficiency of Risk Allocation in Project Financed Infrastructure Transactions by Reducing the Impact of Risk Noise*' [Delmon, 2008]. Specific legal issues related to international project finance and adjacent topics were examined, in particular, by R. Brealey [Brealey, 2014], J. Dewar [Dewar, 2011], S. Hoffmann [Hoffmann, 2007], I. Mubaydeen [Mubaydeen, 2003], P. Nevitt [Nevitt, 2000], P. Orta [Orta, 2011], K. Sin [Sin, 1987], C. Tinsley [Tinsley, 2000], G. Vinter [Vinter, 2006], Ph. Wood [Wood, 2007], E. Yescombe [Yescombe, 2014]. In Ukrainian and Russian doctrine, however, these problems have been only incidentally considered, in particular, by S. Kuznetsov [Kuznetsov, 2016], D. Kuziak [Kuziak, 2010], A. Negoda [Negoda, 2012], Ya. Ovsianikova [Ovsianikova, 2011], V. Tyschenko [Tyschenko, 2013], A. Shamraev [Shamraev, 2009], O. Yunko [Yunko, 2014], though in their writings issues related to project finance and, in particular, project risks have been examined predominantly from economic perspective. Our present research presents a modest contribution to preceding scientific investigations in this field.

The purpose of this article is to examine, classify and categorize various types of risks inherent to international project finance and discuss legal techniques employed by the key participants of project finance to mitigate each of these risks based on thorough examination of project documentation typically elaborated for this purpose.

Main research results. From doctrinal point of view, project risks can be classified into two broad categories, namely commercial and non-commercial risks (sometimes referred to as political or country risks). Commercial risks may further be divided into internal risks (i.e. those incidental to the project and dependent on the type and scope of project) and external risks (i.e. risks of events not directly related to the project, which nevertheless may have adverse impact on the project's viability and likelihood of its implementation). The essence of project finance is identifying the risks and determining who should bear them [Wood, 2007: 5]. It is submitted that risk cannot always be mitigated or contracted away, but it can be assessed, allocated, and managed so that it is commercially reasonable [Dewar, 2011: 81].

A. Shamraev suggests that legal instruments used for elimination (minimization) of risks encompass collateral arrangements (primarily bank guarantees and insurance), contractual mechanisms (conditions precedent of an international loan agreement, preliminary long-term agreements with suppliers and agreements on hedging currency risks with a bank, and agreement with the host state), private international law tools (choice of law and choice of jurisdiction), as well as organizational and legal instruments (incorporation of the project company and opening bank accounts abroad) [Shamraev, 2009: 25].

Among internal commercial risks which pertain specifically to the project itself we should primarily specify completion risk which is a risk that the project will not be completed on time and/or within the estimated budget. Delays in completion may take place when the contractor fails to perform under the construction contract or when the suppliers fail to supply fuel or equipment, or necessary connections to the project. Non-completion of the project may also be caused by force majeure circumstances or any defects inherent in the construction process, as well as legal

deficiencies (for instance, failure to obtain relevant permits, licences or consents for construction of the project (the consent risk), failure to obtain title of ownership or leasehold interest in the project site and any additional land needed for construction).

Delay in completion is one of the major risks for the lenders, since they should be confident that the loan will be repaid out of the project cash-flows starting from a particular date. In case of delay generation of revenues shall evidently be postponed. As a result, the costs for servicing the loan will be higher, because the debt shall remain outstanding during a longer period of time. In addition, penalties may be triggered under the supply contracts or off-take agreements. Overall costs of the project shall be increased, while profit of the equity investors shall fall.

As Ph. Wood observed, in project finance contract is a king. The project contracts involve a sharing of risk: is the risk borne by a project sponsor, a project contractor or the project (the lenders)? [Wood, 2007: 12]. Completion risk is also mitigated primarily by contractual mechanism. Construction contracts should be structured to incentivize timely completion and include appropriate liquidated damages for delay [Dewar, 2011: 84]. A turnkey date-certain construction contract imposing stringent contractual sanctions on the contractor for failure to adhere to the contractual completion date (except for in force majeure circumstances) is a conventional contractual solution mitigating completion risk. As G. Vinter noticed, a fixed price turnkey construction contract is intended deliberately to transfer a greater degree of risk than is normally the case onto the contractor [Vinter, 2006: 94]. Firm completion date is a required milestone date in the project documentation. Failure to meet this deadline will result in penalties for late completion envisaged in the construction contract. Besides, definition of term 'completion of the project' should be carefully considered at the stage of drafting the construction contract in order to avoid unnecessary incomprehension in future.

Banks are usually not prepared to take the whole completion risk and are reluctant to allocate extra money. They may require a completion guarantee from the project sponsors. In the latter case non-recourse funding becomes a limited-recourse financing. In addition, the lenders generally insist on obtaining the construction permits by the project company before advancing any funds under the loan agreement, so compliance with the regulatory formalities available at the host jurisdiction constitutes one of the conditions precedent contained in the loan agreement. In fact, some licences and consents may be obtained only at a later stage, so the consent risk cannot be entirely eliminated. Alternatively, the lenders may feel comfortable if the risk of obtaining the construction and then operation permits is allocated to the contractor which shall bear responsibility for any delays caused by failure to obtain such permits.

Completion risk can also be mitigated by regular on-site inspections and close supervision of the activities of the contractor by the project company's personnel and external engineer employed by the lenders who have qualifications and experience in the area of project. Risk of poor qualification and misconduct of the contractor's personnel and subcontractors is lessened by prior approval by the project sponsors and sometimes the lenders of the key personnel and subcontractors which shall work on the project site. In essence, the project sponsors need to have a high degree of confidence that the project can be completed on time and on budget, is technically capable of operating as designed, and that there will be enough net cash flow from the project's operation to cover their debt service adequately [Yescombe, 2014: 20].

Some projects (such as mining and other extraction of natural resources) tend to be more sensitive to completion risk than others. In such projects delays may be caused by the natural factors, geological or technical problems which could hardly be predicted beforehand. A completion guarantee provided by the project sponsors to the lenders will be an ultimate solution to reduce these risks to the satisfaction of the lenders. Under terms and conditions of such guarantee, the project sponsors shall be responsible for any shortfalls in financing and shall provide funds needed to complete the project.

Risk of excess expenditure is the risk of a considerable cost overrun as compared to initial budget of the project. If this happens, the participants shall need to raise extra capital to complete the project. The lenders may be reluctant to disburse additional money for which they have made no

prior commitments in the loan agreement, and thus replenishment of funds will remain a source of major concern for the project sponsors. Moreover, even if additional funds are in place, the financial structure of the project has been irreversibly modified: the cost of the project has been increased with no corresponding expansion in the revenues to be generated by the project. Therefore, pay-off period of the project will be inevitably extended. If no restructuring of the loan is negotiated with the lenders, such occurrence will mean that the project sponsors will obtain less return on their investment.

Fixed-price construction contract may be seen as a viable solution to diminish the risk of construction costs overruns. As G. Vinter observed, the objective of such a contract is to get the contractor to accept as many as possible of the risks that would result in an increase in the cost of carrying out the works [Vinter, 2006: 107]. However, even in this case the contractor may ask for additional funding, in particular, in case of changes in contractual specifications or changes in laws applicable to the project (for example, introduction of more onerous environmental standards requiring to employ additional waste treatment facilities). In addition, the project sponsors may agree to 'pump' an additional equity capital into the project company to cover any cost overruns at the construction stage. Similarly, to mitigate cost overrun risk, lenders may require that a certain amount of cost overrun support is procured by the project company either by way of allocated debt facilities and/or equity contribution commitments from the sponsors [Dewar, 2011: 85].

Operational risks are the risks related to inadequate performance of the project upon its completion (i.e. if performance falls below the minimum required standard output), hidden defects in technologies used, insufficiency or inadequacy of natural resources needed for the project operation, higher level of maintenance costs and supply costs as compared to their initial assessment and so on. Such risks may result in considerable downturn in the anticipated cash-flow or even financial losses due to higher operating costs.

Key factors contributing to the level of operational risks include malfunctioning of technologies used by the project, unavailability of fuel and equipment, maintenance problems, 'human factor' (negligent operation, poor management, operator's mistakes) and so on. Long-term risks cannot be excluded for sure and forever, even if the project has been properly completed, tested and put into operation. Moreover, they may appear to be unquantifiable, if the project uses new technologies and innovations.

Generally, poor performance of the project due to technical reasons or any mistakes committed during its construction shall result in penalties and other liabilities incurred by the contractor. However, financial sanctions under the construction contract are usually capped and may therefore be inadequate to the level of loss of revenues; the lenders feel more comfortable if the contractor is one of the project sponsors with an equity investment in the capital of the project company, since in case of malfunctioning of the project it will face loss of its equity return, in addition to contractual penalties. Besides, the contractor and/or manufacturer of the equipment, further to a conventional warranty, may provide a long-term performance guarantee covering defects in design and construction emerging due to the contractor's or manufacturer's fault (however, the contractor or manufacturer might argue that defect was caused by maloperation of the project, rather than by its own mistake). Additional coverage of these risks may be obtained from an insurance company as a part of insurance package, but this solution may prove to be very expensive. Furthermore, the project sponsors may provide a long-term performance guarantee to ensure a greater comfort to the lenders in this respect.

Environmental risks in project finance may be entailed by an industrial or similar project generating waste, CO₂ emissions, noise pollutions and other adverse impact on the natural environment. The contractor and operator of the project are required to meet environmental standards during construction and operation of the project. The project company may face the risk of failure to obtain an environmental permit to construct and operate the project (if needed under the applicable laws of the host jurisdiction) or this permit may subsequently be withdrawn, or changes in law may be later introduced and compliance with such advanced environmental standards will require additional expenditures. Violation of these standards may result in severe financial sanctions

applicable to the project company, deterioration of relations with local government and rough opposition of the local community to construction and operation of the project. Even lenders may face reputational challenges in their home jurisdictions for supporting a project which is deleterious for environment. Therefore, conducting an environmental audit of the project may be a condition precedent under the loan agreement to reduce the lenders' concerns.

Risk of insufficient revenues is the risk that the project will generate less profit than is needed to cover its operational and maintenance costs, to service the debt under the loan agreement and to grant adequate return on investment of the project sponsors. In fact, lenders rely on the future cash flow projected to be generated by the project to pay their interest and fees, and repay their debt [Yescombe, 2014: 7]. This risk may emerge if, for example, the production output of the plant is less than anticipated, if the price established for the products is inadequate or uncompetitive given the market conditions or if the volume of the market is not corresponding to initial evaluations. Project may be extremely vulnerable to long-term problems if it operates in instable market environment with tough competition or stringent price control by the host state. Price risk is a specific instance of this risk relating to instable market prices for the project products referring both to supply prices and sales prices.

Such risk may be best covered by an off-take agreement (namely a take-or-pay contract whereby the price risk and risk of low demand to the project products are transferred from the project company to an off-taker), hedge agreement concluded with market intermediaries (hedging the price risk associated with the project products), contracts for difference and long-term sales contract (usually concluded if the project commodities are traded within a limited marketplace). In case of an off-take agreement this risk is transformed into the risk of insolvency of an off-taker. Under the typical form, the project sponsor enters into a purchase agreement with the project company under which the sponsor agrees to buy the project product, e.g. minerals or oil, and to pay for it, even if not delivered for any reason, up to an amount equal to scheduled payments on the bank loans [Wood, 2007: 32].

Sometimes, the project sponsors shall guarantee not only that the project will be completed in time in entire accordance with its specifications, but also that upon its start-up it will achieve the targeted level of efficiency under the relevant cash-flow requirements (a 'revenue guarantee'). Project finance may also take the form of a limited-recourse financing when the sponsors agree to provide the project company with additional funding for debt service in case if the cash-flow generated by the project is not sufficient or is suddenly reduced below the minimum performance criteria. For instance, the project sponsors may agree to pay the interest accrued on the amount of loan if the project company is unable to service its debt due to any shortfalls in the revenues generated by the project.

Supply risk presents the risk of unavailability of the main fuel or the other raw materials or any kind of general utilities (such as electricity and water) which may lead to a delay in completion of the project or result in stoppage of the whole project plant and prevent its operation. If the supplier fails to supply, the project company may suffer loss of its revenue and incur extra cost when engaging an alternative supplier or obtaining other sources of supply. This risk may be minimized by entering into a long-term supply contract for definite volumes of the raw materials with the fixed purchase price which (ideally) will remain unchangeable during the whole life of the project; alternatively, the risk may be passed to an off-taker (if it is prepared to take this risk). The project company should enter into the supply contract with a reliable vendor (for example, a major oil or gas company) having the adequate reserves of the raw materials being in excess of what is required for the project.

External commercial risks (which may also be referred to as 'macroeconomic risks') may include currency risk (i.e. downturn of local currency obtained by the project company in return for the project's products), inflation risk, increase of floating interest rate and so on. They differ from the risks outlined above, since they do not stem directly from the scope and nature of the project itself; rather, they refer to the economic circumstances in which the project is constructed and operates.

Currency risk generally refers to volatility of currency exchange rate (not to introduction of currency control or other regulatory measures impeding unfettered transfer of the currency across the borders of the host jurisdiction, which is commonly treated as a political risk). Currency risk shall arise when the costs and expenses related to the project at the construction stage are paid in one currency, while the loan is provided in another currency. Considerable depreciation of the loan currency may even cause construction costs overrun. Currency risk may also arise upon finalization of construction of the project: if the local currency in which the project company obtains its revenues falls in value, this event will affect its ability to service the debt. This risk can be eliminated if the finance for the project is provided in the local currency, but in practice this may not be possible or practicable, especially in developing countries with weak domestic currency. Alternatively, the contractor and suppliers may be persuaded to quote their prices in the currency of the loan (if permitted by the local legislation and if these persons are prepared to take currency exposure). Currency risk may theoretically be hedged by currency derivatives, such as forward contracts and currency swaps (though in project finance practice they are rarely employed).

Inflation risk is the risk of major increase of the general price level. Inflation in the host jurisdiction (if it occurs at the construction stage) may inevitably lead to escalation of project costs and even costs overrun, as well as to reduction in the return on investment of the project sponsors. This risk is minimized by 'freezing' the prices in construction agreement and fees in most contracts with external advisors. However, inflation at the operation stage may serve as a benefit to the project company and the sponsors offering an optimistic scenario, since the inflated cash-flows will increase the project revenues, while the debt service is not directly subject to inflation.

Interest rate risk will arise if the project is financed by a floating rate loan or bonds (fixed rate loan shall not entail such risk, but, as a matter of practice, funding of the project at a fixed rate is generally unavailable due to high economic risks for the lenders). In this case the cost of debt service shall depend on the level of the floating rate benchmark, such as LIBOR. Lenders borrow funds at the interbank deposit market at such benchmark rate and then lend these funds to the project company adding margin to this base interest rate. Thus, the ultimate interest rate is re-considered every interest period.

Since the interest accrued on the funding loan is not payable during the construction phase and is normally capitalized (i.e. added to the amount of the loan), the interest rate risk shall cause adverse economic consequences when the operation of the project has commenced and revenues are generated: higher interest payments as initially estimated will lead to lower project return, thus reducing the profit extracted by the project sponsors. Therefore, arrangements for hedging the interest rate risk should be put in place when floating rate loan is taken to avoid unnecessary expenses. Such arrangements commonly include interest rate swaps, as well as interest rate caps and floors. Interest rate swap is an agreement between two parties, under which one of the parties agrees to pay a fixed rate on a certain amount to the other party and will obtain from that other party a floating rate (being fixed on that date) on the same amount. In essence, the project company entering into the interest rate swap with its swap counterparty 'hedges' the risk related to its obligation to pay floating rate under the loan agreement with the lenders. As a matter of practice, mutual payments under the interest rate swap are not effected. The relevant payments are netted and one of the parties shall pay the net amount of debt.

In addition to host-country financial risk, political risk is significant in international project finance [Hoffmann, 2007: 23]. Political environment plays a vital role in project implementation. Sustainable development and success of major long-term projects involving considerable financial, material and human resources is impossible without political backing and at least friendly ambience. In a range of situations only direct instruction from the host government authorities may fundamentally change a deadlock situation to the benefit of the project company. Generally, a project is deeply rooted in a local jurisdiction and is vulnerable to adverse changes in political climate and applicable laws. Participants of the project should assess not only economic feasibility of the project, but also its political sustainability which may be ensured only if the project offers beneficial solutions to the local community and host state as a whole. Political risks (or sovereign

risks of a country) are significantly high, if the project is located in a developing country with instable political situation and weak central government.

Political risks are rather wide in scope and encompass risks of loss of investment by virtue of governmental actions (for example, due to expropriations without compensation, nationalisation, confiscation of property due to political reasons *etc.*); risks related to political and civil force majeure circumstances, such as wars, military actions, civil disturbance and disorders; risks of adverse changes of local legislation and regulations; risks of repudiation of a contract concluded with a sovereign party.

Expropriation of the project company's assets and other property related to the project is one of the major political risks which cannot be entirely excluded even in the case when a concession agreement is in place and the host government demonstrates most favoured treatment to the project. National government always has a sovereign right to seize private assets in emergencies, for example, in war time if this is needed in the interests of national security. However, the government usually provides compensation for such seizure of property. By contrast, expropriation is a coercive measure which constitutes seizure of the privately owned assets without payment of just compensation. If the project suddenly appears to be in the public ownership, the lenders and investors may obtain nothing even to cover their previous expenses related to the project. Practically, the host government may declare the project to be nationalized, or seize the assets of the project company, or may gain control over the project company obtaining the power to appoint its governing bodies and take other essential decisions. There are a lot of indirect measures of political pressure which may be used by the host state authorities to deprive the project company or the project sponsors of the ultimate benefit from the project or even to take the project over. Concession agreement or government support agreement cannot be seen as a 'panacea' against this risk, but they may provide for compensation payable in such case.

Civil turbulence, military actions, terrorist attacks and other forms of political violence may also be extremely harmful for the project causing physical damages or preventing its normal functioning and operation. Blockades and embargoes introduced externally in respect of the host jurisdiction may equally prevent successful completion of the project due to unavailability of equipment of raw materials supplied from abroad. Mitigation of such political risk by insurance or public guarantees may be required by the lenders, especially in case of permanent political instability within the host state.

Changes in law may pose a significant threat to the project, increasing the costs of the project, frustrating the project company's rights and ability to operate, invalidating key project contracts and, at worst, rendering further project activities illegal. Choosing the jurisdiction for launching the project the participants should investigate whether its 'legal climate' is friendly enough for the project. In particular, they must ascertain that investment legislation of the host jurisdiction offers general guarantees for the overseas investors; that intended project may be privately owned and operated; that legal and regulatory framework for the project is clear, transparent and comprehensible without any discrimination in obtaining licences and permits vital for the project. However, even the most scrupulous analysis of the local legislation cannot peremptorily protect the project against any subsequent changes in law, changes in regulations, changes in courts' attitude towards a particular legal issue or interpretation of legal notions (notwithstanding that a court decision does not change any law). Adverse legal changes may include, *inter alia*, increase of existing taxes or introduction of new taxes (especially withholding taxes on the dividends and interest payments to non-residents) and import duties payable within the project, which reduce the profit of the project sponsors; imposition of import control on equipment or raw materials needed for the project; changes in exchange control and investment regime (for instance, introduction of prohibition on repatriation of foreign investment); changes in employment control (for example, introduction of new work permits for foreigners), operational safety and health care rules which may increase the cost of compliance by the project company with the local labour legislation; unilateral amendments in or invalidation of the concession agreement concluded by the local public authorities with the project company; trade prohibitions; amendment or withdrawal of licences and

permits initially provided to the project company or contractors in respect of the project implementation.

In general, the risk of negative legal changes should be borne by the end customers of the products or services (though this may be possible not in each case). Raising alternative funding by the project company to finance additional costs may face various difficulties. Existing lenders may be reluctant to provide extra finance and search for new lenders may prove to be futile under such circumstances.

Protective legal measures against political risks may include the following:

- Incorporation of the project company outside the host jurisdiction. The project company is usually incorporated in the country in which the project is taking place, although it may occasionally be beneficial to incorporate it outside the country concerned [Yescombe, 2014: 40]. This solution, however, is rarely workable, since local 'nationality' of the project company may be prescribed by the laws of the host jurisdiction;
- Subjection of the main project contracts to external applicable law and jurisdiction. It should be noted that this measure may also prove to be impracticable since the assets of the project company are located within the host state and may be easily seized, and licences and concessions will invariably be governed by local law;
- Contractual allocation of political risks between the lenders and project sponsors (for instance, the banks may agree to take political risk, while the commercial risk shall be borne by the project sponsors); the syndicate of banks may also include public lenders which are prepared to accept political risks not acceptable for the private lenders;
- Guarantees from the local government (for example, freezing of taxes or state guarantees applicable to the foreign investors as of the date of launching the project). As a minimum, the host government may introduce a non-discrimination clause into the concession agreement obliging not to pass any rule of law or introduce any action having potentially discriminatory effect on the project company and the project itself (however, in most cases adverse legal changes affect the whole industry in which the project operates and normally is a part of the overall risk of doing business locally);
- Bilateral international treaties (the project sponsors may benefit from such treaties if they are located within the state having favourable international treaty with the host jurisdiction).

Multilateral agencies can assist in reducing legal and political risks and thereby generate standards for financings [Hoffmann, 2007: 20]. In particular, political risks may also be insured with the Multilateral Investment Guarantee Agency (the 'MIGA'). This is an international financial institution which provides political risk insurance and credit enhancement guarantees. The MIGA's guarantees protect investments against non-commercial risks and can help investors obtain access to funding sources with improved financial terms and conditions. The MIGA was created under the Convention Establishing the Multilateral Investment Guarantee Agency 1985 (the 'MIGA Convention') [1].

Scope of non-commercial risks which may be guaranteed by the MIGA is set out in Article 11 of the MIGA Convention and includes:

- currency transfer risk (any introduction attributable to the host government of restrictions on the transfer outside the host country of its currency into a freely usable currency or another currency acceptable to the holder of the guarantee, including a failure of the host government to act within a reasonable period of time on an application by such holder for such transfer);
- expropriation and similar measures (any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories);
- breach of contract (any repudiation or breach by the host government of a contract with the holder of a guarantee, when (a) the holder of a guarantee does not have recourse to a judicial or arbitral forum to determine the claim of repudiation or breach, or (b) a decision by such forum is not rendered within such reasonable period of time as shall be prescribed in the contracts of guarantee pursuant to the MIGA's regulations, or (c) such a decision cannot be enforced); and
- war and civil disturbance (any military action or civil disturbance in any territory of the host country to which this Convention shall be applicable).

In addition, the Board of MIGA, by special majority, may approve the extension of coverage to specific non-commercial risks, other than those referred to above, but in no case to the risk of devaluation or depreciation of currency.

Conclusion. Project risks present a complex of potential events which may have an adverse impact on implementation and performance of project and/or solvency of its participants. These risks should be classified into commercial (internal and external) and non-commercial risks, with different legal mechanisms to be applied for their elimination. Some of these risks (including completion risk, risk of excess expenditure and price risks) may be mitigated through contractual arrangements, such as a date-certain fixed-price construction contract imposing stringent contractual sanctions on the contractor for completion delay and budget overruns or off-take agreements, or by means of additional obligations imposed on project sponsors and fixed in separate documentation (in particular, a completion guarantee, performance guarantee or revenue guarantee). The main principle of allocation of project risks is assignment of liability related to a particular risk on a person who can best manage such risk. Political risks require the most comprehensive scope of protective legal measures due to their specific features, and international measures (including bilateral treaties on mutual protection of investment) should be considered as the most viable protection against such risks.

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