FLOATING CHARGE AND RECEIVERSHIP IN PROJECT FINANCE: LESSONS FOR NEPAL

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ABSTRACT

Financing of long-term infrastructure, industrial and energy projects involves a complex set of transactions, often referred to as 'Project Finance'. This, in particular, includes taking of security interest over some or all of the project assets, especially on receivables to be generated by the completed project to secure financing. The security, however, may play more roles besides being a precondition for getting financing.

From this perspective, English law's floating charge is particularly suitable for this context because through it the creditors may encumber all present and future assets (including receivables) of the project company and does not require registration of security against each specific asset. More importantly, the floating charge may additionally give the lenders the right to appoint a receiver upon crystallization and through that take over the entire project if deadlock arises. Such step-in right of creditors is often crucial for the completion of projects.

Nepal has adopted separate law on secured transaction law, among others, to regulate and address the concerns of lenders in project finance. The law is, however, silent on floating charges, the possibility of the appointment of receivers and on the concomitant step in rights. In light of this deficiency of Nepalese law, this thesis will examine the concept of floating charge and receivership offered by English law specifically in the context of project finance. The thesis will try to show and pave the way for further research that the English experiences with the floating charge and receivership can become an important method to ensure successful completion and running of various projects in financed via project finance in Nepal.

DEFINITION OF KEY TERMS

Asset: The physical project contract rights, and interests of every kind related to the project, in the present or future which can be valued or used to repay debt.[1]

Charge: Security over an asset which gives the lender right to obtain the asset in the if the borrower fails to discharge the debt.[2] In English law, charge is classified into fixed charge and floating charge.[3]

Chargor: Entity who grants a charge in favour of a chargee**.**[4]

Chargee: Entity in whose favour charge is granted by a chargor.[5]

Concession: License or lease granted to the project company to exploit, develop, construct and operate the project.[6]

Limited Recourse: Model of financing in project finance where lender obtains guarantee from sponsor for the debt repayment (besides the project's cash flows). There is usually recourse in the event of fraud or misrepresentation/non-disclosure.[7]

Non-Recourse: The model of financing in project finance where financiers rely on the project cash flows and collateral security over the project as the only means to repay debt.[8]

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[1] C. Richard Tinsley, *Project finance: introduction and glossary; risk analysis and allocation; project feasibility and credit factors; structuring and funding; legal and documentation issues* (Euromoney 1996).

[2] Glossary <https://uk.practicallaw.thomsonreuters.com/2-107-5890?originationContext=document&transitionType=DocumentItem&contextData=%28sc.Default%29&comp=pluk> accessed on 14 March 2019.

[3] Tinsley (n 1).

[4] Glossary <https://uk.practicallaw.thomsonreuters.com/5-107-5898?originationContext=document&transitionType=DocumentItem&contextData=%28sc.Default%29&comp=pluk> accessed on 14 March 2019.

[5] Glossary <https://uk.practicallaw.thomsonreuters.com/1-107-5895?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)&comp=pluk&firstPage=true&bhcp=1> accessed on 14 March 2019.

[6] Dentons, 'A Guide to Project Finance' 19 <https://www.dentons.com/~/media/6a199894417f4877adea73a76caac1a5.ashx> accessed 5 January 2019.

[7] Tinsley (n 1).

[8] Ibid.

Pari passu: Equal ranking of security pro rata the amount owned.[9]

Project Company: Special Purpose Vehicle which raises finance for the project, holds the concession /license.[10]

Pro rata: Shared or divided according to a ration or in proportion to participations.[11]

Receivable: Amount owed to a business by debtors. In context of project finance, represents the assets or debts received by Special Purpose Vehicle/project company from the entity who generated assets or debts.[12]

Security Agreement: Agreement that provides lender a security interest in a asset or property that is pledged as collateral.[13]

Special Purpose Vehicle (SPV): Legal entity which is established for the purpose of a particular project.[14]

Project Sponsor: A person/s or entity who is involved in starting and structuring a project and is the shareholder or owner of all or a part of Project Company.[15]

[9] Tinsley (n 1).
[10] Dentons (n 6) 9.
[11] Ibid.
[12] Glossary <https://uk.practicallaw.thomsonreuters.com/3-107-7110?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1> accessed on 20 February 2019.
[13] Security Agreement <https://www.investopedia.com/terms/s/security-agreement.asp> accessed on 8 March 2019.
[14] Dentons (n 6) 11.
[15] Ibid 10.

INTRODUCTION

i. Financing mechanism for infrastructure projects

Government funding, banking finance, tapping capital market and project finance are some of the financing mechanisms available for the infrastructure projects.[16] Governments may in part or full fund infrastructure projects with capital investment or other forms of cooperation with the private sector like granting concessions.[17] Governments may also provide direct support for the projects through subsidies/grants, and/or debt.[18] Generally, government funds or gets involved in these projects where the project does not in its own merit achieve bankability, financial viability or is otherwise subject to specific risks that the private investors or lenders are not well placed to manage.[19]

Banking finance is one of other mechanisms to finance infrastructure projects.[20] Infrastructure projects financed through banking finance are often structured in a consortium because of the size of the project is too large or too risky for a single lender, what is normally referred to as syndicated lending.[21] Infrastructure projects can also be financed through private investment or through corporate balance sheet finance using finance instruments including bonds, loans, equity finance *et al.*[22]

[16] Main Financing Mechanisms for Infrastructure Projects <https://ppp.worldbank.org/public-private-partnership/financing/mechanisms> accessed 15 January 2019.
[17] Ibid.
[18] Government Support in Financing PPPs <https://ppp.worldbank.org/public-private-partnership/financing/government-support-subsidies> accessed 15 January 2019.
[19] Ibid.
[20] OECD, 'Infrastructure Financing Instruments and Incentives' 13 < http://www.oecd.org/finance/private-pensions/Infrastructure-Financing-Instruments-and-Incentives.pdf> accessed 15 January 2019.
[21] Loan Syndication vs. a Consortium: What's the Difference? <https://www.investopedia.com/ask/answers/112814/what-difference-between-loan-syndication-and-consortium.asp> accessed 8 February 2019.
[22] OECD (n 20) 15-16.

Project Financing is yet another mechanism to finance the infrastructure projects. In this financing mechanism, financing is based on the cash flow generation of the project and potential viability of the project .[23] Organization of Economic Cooperation and Development note that "as a result of increased budgetary constraints, the financing of infrastructure has increasingly taken the form of project finance."[24]

ii. Importance of Security in financing of infrastructure projects

Undertaking infrastructure projects requires a lot of resources and substantial amount of money. Finance for such projects is generated through one of the mechanisms stated above. In either of the mechanisms, security has an intrinsic role in financing of such projects. Security improves the terms on which credit is available, typically by increasing the amount of loan, by extending the period for which loan is granted and by lowering the interest rate.[25] Both real and personal property are used for the purpose of security. Security devices making use of these proprieties provide the basis for obtaining credit or financing the infrastructure projects. It is therefore notable that credit is obtainable if reliable system of securities is available. This is ensured by effective securities law and secured transaction law through which any kind of asset can be used as collateral.

iii. Research Aim

Project Finance as the mechanism to financing of the infrastructure projects like Hydropower projects in Nepal has been quite popular in recent years. Securing loan against the project assets and its receivables is key to finance large infrastructure projects. Comprehensive security laws and secured transaction law is necessary to create the security in the project's movable and immovable assets and intangible property, perfect the security and enforce the security. Nepal enacted Secured

[23] Ibid 16.
[24] Ibid 13.
[25]Tibor Tajti, *Comparative Secured Transactions Law* (Akadémiai Kiadó 2002) 67.

Transaction Act to facilitate the creation, perfection and enforcement of security in relation to movables and intangible property and to promote economic activity for the economic development.[26] Number of projects financed using project finance mechanism to finance the infrastructure projects in Nepal have used the concept of floating charge and receiver charging the present and future assets and receivables of the project against the loan obtained by the project company. Secured Transaction Act of Nepal, however, is silent about the floating charge and receivership. This thesis would discuss the concept of floating charge and receiver, its development and importance in the project finance. It would further review Secured Transaction Law of Nepal and discuss the relevancy of floating charge and receivership in Nepalese context.

iv. Structure of Thesis

Chapter one discusses the features of project finance distinguishing it from other form of financing. It also illustrates the importance of security and its role in project finance transaction. Chapter two discusses about creation of security interest in project finance focusing on the creation of security interest through floating charge. It will also discuss the differences between floating and fixed charge. It will highlight and discuss the events which causes the conversion of floating charge to fixed charge which is referred as crystallization. It will further illustrate the importance of floating charge in project finance transaction. It will also outline the general overview of secured transaction law of Nepal in context of project finance. Chapter three will discuss lenders' right in context of projects which are in trouble including right to step in and right to appoint the receiver in the project company. It will also examine the relevancy of such rights in Nepalese context by assessing enforcement rights of lenders in relation to security interest under English law and Nepalese law.

[26] Secured Transaction Act of Nepal 2006, Preamble.

CHAPTER 1

PROJECT FINANCE AND ROLE OF SECURITY

Creation of security and its enforcement are among others important in the Project Finance transaction. Floating charge among others is one of the ways to create security in secured transaction. Floating charge is the available way of exercising the step-in right and appointing receiver to enforce the security interest. The purpose of this chapter is to highlight some of the key characteristics of project finance as one of the mechanisms to finance the infrastructure projects and the role and importance of security in project finance transactions.

1.1 PROJECT FINANCE AND ITS KEY CHARACTERISTICS

Project finance is the financing of large infrastructure projects where a special purpose vehicle, project company, formed by the project sponsors is the borrower. In project finance, soundness and creditworthiness of the project sponsors does not affect financing of the project company.[27] Gatti notes that lenders in this form of financing consider cash flows in the project company as the primary source of loan reimbursement while asset represent only collateral.[28] Principal assets of the project company in the project finance transaction at the time of closing generally are contracts, licenses and plans for cash flow.[29]

Project finance is tailored to meet the needs of the specific project.[30] Identifying and determining the risk and who should bear them is important in project finance.[31] Identified risks are shared

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[27] Stefano Gatti, *Project Finance in Theory and Practice: Designing, Structure and Financing Private and Public Projects* (Elsevier Academic Press 2008) 2.
[28] Ibid.
[29] Phillip Fletcher, 'Approaching Legal Issues in a Project Finance Transaction' in John Dewar(ed), I*nternational Project Finance: Law and Practice* (OUP 2011) 1.
[30] IFC, 'Project Finance in Developing Countries' < http://documents.worldbank.org/curated/en/952731468331147256/pdf/multi0page.pdf> accessed 20 January 2019.
[31] Philip R Wood, *Project Finance, Subordinated Debts and State Loans* (Sweet and Maxwell 1996) 6.

through project contracts among project sponsor, project contractor, lender and different other types of investors.[32] This form of financing is, therefore, dependent upon detailed evaluation of a project's construction, operating and revenue risks, and their allocation between investors, lenders, and other parties through contractual and other arrangements.[33] Hence, project finance is different from corporate loan which is primarily lent against company's balance sheet and projections from its past cash flow, profit record and assumption that company will remain in the business for long term.[34]

Two variants of financing are used in the project finance, non-recourse and limited recourse. Non -recourse project finance is an arrangement under which investors and creditors financing the project do not have any direct recourse to the project sponsors while limited recourse project finance permits some recourse to the project sponsors[35]. In limited recourse, lenders consider pre-completion guarantee during a project's construction period, or other assurances of some form of support for the project, however, still depend on the success of the project as the primary source of repayment.[36] International Finance Corporation note that limited recourse model of project finance is generally used in financing projects in most of the developing market projects and other projects with significant construction risk.[37]

In an effort to define project finance, Gatti provides five distinctive characteristics of project finance. *First*, debtor is special purpose entity set up on an *ad hoc* basis, financially and legally independent from project sponsors. *Second*, lenders generally have limited recourse or no recourse at all to the sponsors of the project after the project is completed. *Third*, risks associated with the

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[32] Ibid.
[33] E.R. Yescombe, *Principles of Project Finance* (Academic Press 2002) 1.
[34] Ibid 8.
[35] IFC (n 30).
[36] Ibid.
[37] Ibid.

project are equitably allocated and assigned through contractual arrangement. *Fourth*, cash flow generated by the project company must be sufficient to cover operating cost, repayment of debt and interest. *Fifth*, collateral is limited to the assets and receipts of the project company.[38] Hoffman incorporates all of the aforementioned elements to provide a comprehensive definition of project finance. He notes:

> "Project finance is generally used to refer to a nonrecourse or limited recourse financing structure in which debt, equity, and credit enhancement are combined for the construction and operation, or the refinancing, of a particular facility in a capital-intensive industry, in which lenders base credit appraisals on the projected revenues from the operation of the facility, rather than the general assets or the credit of the sponsor of the facility, and rely on the assets of the facility, including any revenue-producing contracts and other cash flow generated by the facility, as collateral for the debt."[39]

Hence, it is clear from above that project finance and its legal aspects is takes shape around two important components which are i) the project company and ii) the agreements which relates to the project.

Like any other financing transaction, Project Finance also requires documentation to structure the financing, security and the like. Generally, documentation in the Project Finance involves three types of documents which are i) the finance documents, ii) security documents and iii) project documents.[40]

[38] Gatti (n 27) 2.
[39] Scott L. Hoffman, *The Law and Business of International Project Finance: A Resource for Governments, Sponsors, Lenders, Lawyers and Project Participants* (Transnational Publishers 2001) 65.
[40] Gatti (n 27) 242.

Finance documents include those agreements under which the project is financed. A project is always financed from several different sources including preliminary financing by its sponsors and third-party financers. The financing from third party financers are structured via finance agreement or credit agreement or facilities agreement.[41] Security documents include the documents which create security interest in favour of lenders. Varying from jurisdiction to jurisdiction it can be in the form of security agreement or security deed. Gatti notes that in project finance, security documents are separated from the finance documents due to the fact that legal requirements of the jurisdiction where the assets are located regulate the creation and enforcement of security interest.[42] Project documents include project company's operational agreement or agreement that is related to the project. In project finance, project company cannot have agreement which is not related to the structuring of the financing of the project company.[43] These project documents include but are not limited to concession agreement, construction contract or development management agreement, supply agreement, sales agreement and operating agreement.[44] Lenders are not the parties to the project documents in project finance transaction. Nevertheless, lenders acquire rights in relation to the project documents through security documents and direct agreement with the parties related to the project.[45]

It is important to note that host government, project sponsors, lenders and contractors of the project are the major parties which are related in project finance. The objective of the parties involved in the activity of the project company, particularly host government, project sponsor and lender, are different. Host government's interest is met if the project is completed as soon

[41] Ibid.
[42] Ibid 243.
[43] Ibid.
[44] See Graham Vinter, Gareth Price, David Lee, *Project Finance*, (Sweet and Maxwell 2013) 89-90.
[45] Gatti (n 27) 243.

as possible and if it is able to transfer the risk related to the financing of project from public sector to private sector.[46] The objective of the project sponsors is to complete the project, make profit out of the project, share the risk in undertaking the project, minimize the interference in the operation of the project company and to retain the control of the project as long as possible in the time of hardship or difficulty.[47] Lenders, likewise, desire to make profit out of the debt it grants to the project company, have control over the key project decisions that is directly related to the operation of the project company and to take control of the project as soon as possible in the times of hardship or difficulty.[48] It is apparently clear from above that both the project sponsor and lender want to acquire and maintain the control of project in the time of hardship or trouble. Security in this scenario has important role as it helps to achieve the control function in Project Finance. The functions of security in project finance are discussed below.

1.2 FUNCTIONS OF SECURITY IN PROJECT FINANCE

Security in the financing transactions is used for number of reasons including giving lenders priority over unsecured creditors of the borrower, better chance of recovering debt in the scenario of bankruptcy and exercise control over the borrower's assets[49]. This is often referred as the enforcement function or positive function of security.[50]

Enforcement function or the positive function of security is equally applicable in project finance. Nevertheless, it is essential to note that security package in project finance is structured based on nature and function of project company.[51] The project company does not own any material assets

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[46] Vinter (n 44) 2.
[47] Ibid 3.
[48] Ibid.
[49] LexisPSL Banking & Finance, 'Security in project finance transactions—overview' <https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document/391289/55KB-65S1-F185-X04X-00000-00/Security_in_project_finance_transactions_overview#> accessed 24 January 2019.
[50] Ibid.
[51] Gatti (n 27) 266.

except some licenses and permits at the outset of the project; it buys or undertakes most part of the construction with the proceeds of loans.[52] Some form of security is ,therefore, generally sought from the project sponsor (in limited recourse model) and project's construction contractor in the form of guarantee or performance bond.[53] Another distinctive form of security in the project finance is the direct agreement between lenders and project parties such as operators, suppliers, off-takers of project and services.[54] This allows the lender to step into the shoes of the project company.[55] The function of security, in this perspective, can be broadly discussed as the defensive function and control function.

According to Philip Wood, finance security has a defensive function in project finance as "it is shield not a sword".[56] It is true in the sense that the aggregate value of the secured assets in the project finance and loans conferred is not proportionate to the recoveries which may be obtained in case of the enforcement of the security against assets in case of default.[57] The defensive function relates to protecting the project and its property from the claims of third parties. In the words of Gatti, these claims of third parties may be from sponsors' creditors claiming settlement for their loans on the project company's corporate capital pledged in the favour of project lenders or creditors to the project company itself.[58] In this scenario, security interest directly in the project company's assets prevents assets from being subject to enforcement by third parties' who would have competing rights with the project lenders in relation to project assets, project revenues.[59] This

[52] Ibid.
[53] Jan-Hendrik Rover, 'Security in Project Finance and PPP and implications for secured transactions law: "Security is a shield, not a sword"' in Frederique Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar Publishing 2015) 240.
[54] Ibid.
[55] Ibid.
[56] Wood (n 31) 30.
[57] Gatti (n 27) 267.
[58] Ibid 300.
[59] Ibid.

also prevents the third parties ability to seize the assets of the project company which are essential to the operation of the project.[60] Hence, security in project finance puts the lenders in the superior priority over the actions by junior and unsecured creditors.[61]

Nevertheless, there is debate whether security in project finance only has a defensive function. In this regard, Jan Hendrik Rover notes lenders can make almost no use of the positive role of security in the early stage of project because of lower value of project asset in comparison to amount of project loan.[62] He further notes the scenario is different when the project is in the operation phase, project company and its assets will become valuable and positive function of the security can be alternative to the defensive function.[63]

Another function of security in project finance, of heightened importance for us here, is control over the project. The control function of security is different compared to the conventional financing in the sense that it has two roles. First, lenders exert control in the management through the direct agreements and comprehensive security over project's assets in the event of default. This aspect control function has also been referred as the management function by number of scholars.[64] Management function of security entitle lenders or the nominee appointed by them to do more than sell the assets i.e use and control the asset and project company.[65] Vinter *et al* note that function of security from this perspective is to give the lenders option of taking over the project, completing or operating it themselves so that they can collect their debt from revenues of the project or later recover the debt through the sale of the project.[66] The control over the management of the company

[60] Ibid.
[61] Rover (n 53) 244.
[62] Ibid 246.
[63] Ibid.
[64] Vinter (n 44) 269.
[65] Ibid.
[66] Ibid.

is possible either through the use of English floating charge which allows appointment of a receiver or through direct agreement with key project parties with the ability to take over the project.[67] Control can also be exercised through the pledge of the shares of the project company[68], which is however subject to the local laws of the particular jurisdiction.

Second, lenders exert control over the collective insolvency proceedings if insolvency proceedings are started against the project company.[69] Vinter *et al* note that control over the insolvency proceeding is the outcome of both defensive function and management function of the security as some jurisdiction provide for the rights of lenders to appoint insolvency practitioner of their choice upon whom lenders can exert influence over the operation of the proceeding including decisions related to selling the project assets, permitting the use of project assets to complete project and the like.[70]

Project structure and security enhances the creditworthiness or bankability in financing.[71] In project finance, wide array of security devices, quasi security devices, agreements and the like are used to ensure that the financing is viable. The documentation of the security package is completed accordingly. However, in project finance, lenders have two major concerns in relation to the underlying agreement of the project company[72]. First, to ensure that effective security over the agreements related to the project is taken.[73] This means that the agreements should be chargeable or assignable to lenders.[74] Second, to ensure that all key agreements related to the project are valid

[67] Ibid.
[68] Gatti (n 27) 2.
[69] Vinter (n 44) 155.
[70] Ibid 270.
[71] Ibid 269.
[72] Ibid 171.
[73] Ibid.
[74] Ibid.

and operational when they enforce security.[75] Hence, it can be noted that proper laws related to creation of security and its enforcement is essential for the functioning of project finance.

[75] Ibid.

CHAPTER 2

CREATION OF SECURITY INTEREST IN THE PROJECT FINANCE

Creation of security interest in the project assets, its receivables and its enforcement is subject to the laws of the countries where project finance transactions are undertaken. The law should provide for the mechanism where all present and future assets, receivables and the like can be used as security, have a clear priority rule and provide for enforcement mechanism.[76] International Law Firm Dentons in their Guide to Project Finance note that English security law allows the taking of universal security, is extremely flexible and is generally thought to favour lenders in the context of project finance.[77] Importantly, it allows security to be taken over all of a company's property, assets and business, through the use of the floating charge and allows enforcement without involving the courts[78]. Also, sale is not the only enforcement remedy in floating charge, a secured lender can also operate an asset to enforce the security in the exercise of the step in right.[79] This chapter will discuss the English fixed charge and floating charge as one of the ways of creating the security interest in project finance transactions and analyze whether floating charge is the best model of security creation for the project finance. This chapter will also review secured transaction law of Nepal and discuss the ways of creation of security interest provided by the law. It will further discuss whether the available ways correspond to the English floating and fixed charge.

[76] Dentons (n 6) 45.
[77] Ibid.
[78] Ibid.
[79] Ibid.

2.1 FIXED AND FLOATING CHARGE UNDER THE ENGLISH LAW

English law provides for a number of ways to create security interest in the property. It includes mortgages, charges (fixed and floating), pledges and liens.[80] Charge is a security interest created without any transfer of title or possession to the beneficiary.[81] Nevertheless, the transfer of possession does not preclude characterizing the security interest over property as charge.[82] A charge can be granted over all forms of personalty, future property and interests in choses in action.[83] Charge grants certain rights over the property as the security including right of recourse to property for security purposes.[84] A charge itself does not give the right to possession of the secured property whether or not there is default in the performance of the secured obligation.[85] The secured party can, nevertheless on default, obtain the possession indirectly through the appointment of receiver.[86] The English legal regime recognizes security provider's equitable right to redeem the charge.[87] Security provider can redeem the charged property through late performance before secured party enforces the charge.[88] However, this does not impair secured party's right to enforce security.[89]

English law recognizes two types of charge: fixed charge and floating charge. Fixed charge is the "appropriation of real or personal property for the discharge of a debt or other obligation".[90] Through fixed charge, security interest in property attaches immediately upon the creation of

[80] Gerard McCormack, 'Pressured by the Paradigm: The Law Commission and company security interest' in John de Lacy(ed), *The Reform of UK Personal Property Security Law Comparative Perspective* (Routledge 2010).
[81] Gerard McCormack, *Secured Credit under English and American Law* (Cambridge University Press 2004) 3.
[82] P.A.U Ali, *The Law of Secured Finance: An International Survey of Security Interests over Personal Property* (Oxford University Press 2006) 110.
[83] Ibid.
[84] McCormack (n 81) 44.
[85] Ali (n 82) 110.
[86] Ibid.
[87] Ibid.
[88] Ibid.
[89] Ibid.
[90] Eilis Ferran, 'Floating Charges - The Nature of the Security' (1988) 47(2) Cambridge LJ 213, 213.

charge or acquisition of the rights in the charged property.[91] The debtor can obtain the charged property from the lender only if lender grants the consent to do or through the satisfaction of the debt.[92] Further, creditor's claim in the fixed charge is proprietary not merely personal.[93] The fixed charge attaches itself to property which is ascertained and definite, or property capable of being ascertained and definite.[94] Security interest created through fixed charge gives the charge holder or the secured creditor the priority over other unsecured creditors.[95] Fixed charge is used in combination with floating charge in the project finance. Fixed charge, hence plays a supplemental role in the project finance which gives the secured creditor priority over other creditors and also prevents the chargor from dealing with the property as it pleases without the consent of the chargee.[96]

Floating charge is the security device which creates security interest over present and future property of the security provider. This, nevertheless, does not mean that floating charge is a future security. It is present security which all the assets of the company expressed to be included in it.[97] Floating charge extends to the widest range of assets from land to intellectual property.[98] It grants the security provider freedom to deal with or dispose the property in the ordinary course of business until some event occurs which causes lender to intervene. Such events are referred as crystallization.[99] Debtor has the unfettered dominion to manage the assets covered by the floating charge until crystallization.

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[91] Tajti (n 25) 91.
[92] Ibid.
[93] Ferran (n 90) 214.
[94] Akshay Sewlikarm, 'Floating charges in India: a comparative analysis' (2015) 26(6) International Company and Commercial Law Review 191, 193.
[95] Ibid.
[96] Ibid 193-194
[97] Ferran (n 90) 214.
[98] Tajti (n 25) 257.
[99] Ali (n 82) 115.

The concept of floating charge historically evolved in England. *Holroyd v Marshall*[100] was the first case which noted that equity would recognize a charge over after acquired property as effective to create security interest at the time of acquisition.[101] Scholars agree that *Holroyd v Marshall* was not a case concerning the floating security devices but acknowledged the possibility of creating the charge over the after acquired property.[102] It is noted that the first case in which the floating security was tested and upheld was *Re Panama, New Zealand and Australian Royal Mail Co.*[103] The case was concerned about the charge of company's undertaking and all sums of money arising out of it. The court held that the word undertaking signified not only the income from the business but also present and future property of the company.[104]

Since *Re Panama*, several cases have discussed and developed the concept of floating charge. In *Agnew v Commissioner of Inland Revenue*[105], Lord Millet stated:

> "The Floating charge is capable of affording the creditor, by a single instrument an effective and comprehensive security upon the entire undertaking of the debtor company and its assets from time to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder."[106]

Romer LJ in *Re Yorkshire Woolcombers Association Ltd*[107]highlighted three characteristics of floating charge which frequently cited even today. They are:

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[100] [1862] 10 HLC 191, 11 ER.
[101] Ewan MckendRick (ed), Royston Miles Goode, *Goode on Commercial Law*, (4th edn, Penguin Books 2010) 721.
[102] Ibid.
[103] [1870] 5 Ch App 318.
[104] MckendRick (n 101) 723.
[105] [2001] 2 AC 710.
[106] Ibid 717-718.
[107] [1903] 3 Ch 284.

1. “It is a charge on a class of assets of a company present and future;
2. Class of assets in the ordinary course of business changes from time to time;
3. The Company may carry on its business in the ordinary way as far as concerns the particular class of assets until some further step is taken by or on behalf of those interested in the charge.”[108]

The recent and leading case in relation to floating charge is *Re Spectrum Plus Ltd*.[109] The court noted that it is the third of Romer LJ’s characteristics which is the ‘hallmark of floating charge’.[110] The court clarified that chargor’s the ability to remove an asset from the scope charge will result in the conclusion that charge is floating charge.[111] It also noted that the important character of the floating charge is that charge giver was left free to use the charged asset and to remove it from the security.[112]

Floating charge and fixed charge are consensual security interests. It is dependent upon the intention to grant the charge as evidenced in the security agreement or security transfer.[113] However, it has been noted that designation of the charge as floating or fixed is not sufficient to establish the nature of charge.[114] The court assesses the overall documents and the substance of transaction to determine whether the charge is fixed or floating.[115] The differentiation between floating and fixed charge is important in the creation of the security interest as fixed charge has higher and stronger priority position compared to floating charge.[116] Fixed charge is, therefore, for

108 [1903] 3 Ch 284 295.
109 [2005] UKHL 41 2 AC 689.
110 Ibid 106.
111 MckendRick (n 101) 723.
112 McCormack (n 81) 44.
113 Ali (n 82) 116
114 Ibid.
115 MckendRick (n 101) 723.
116 Tajti (n 25) 258.

priority while floating charge has control function. In this regard, the court in *Re Coslett (Contractors) Ltd*, held:

> "The essence of floating charge is that it is a charge not on any particular asset but on a fluctuating body of assets which remain under the management and control of the chargor and which the charger has the right to withdraw from the security despite the existence of the charge. The essence of the fixed charge is that the charge is on a particular asset or class of assets which the chargor cannot deal with free from the charge without the consent of charge. The question is not whether the chargor has complete freedom to carry out his business as he chooses but whether charge is in control of charged assets."[117]

Hence, it is clear that if debtor is in fact to be left free to manage the charged assets as if they were its own the court will treat the charge as a floating charge over those assets whatever the label the parties themselves have given the charge. However, in practice, lenders may limit the right to manage the charged assets by restrictive covenants which prohibits the subsequent creation of security ranking ahead of and some cases, *pari passu* with the floating charge without the consent of the secured party's consent.[118] It is common in the project finance transaction to use of restrictive covenants in the security agreements to prevent the creation of security ranking ahead and *pari passu* with the floating charge. It strengthens the lender's control over the project company and its assets.

Crystallization is one of the important features attached to the floating charge. It is an event that causes floating charge to become fixed.[119] On crystallization, the security provider's right to control and manage the secured property ceases and the secured property is brought within control

[117] [1998] Ch 495 510.
[118] Ali (n 82) 118.
[119] Tajti (n 25) 258.

of secured party.[120] Crystallization does not, however, constitute the grant of a new fixed charge over the secured property, the original floating charge assumes the character of the fixed charge. Hence, upon crystallization the chargee has all the rights of the chargor and company's actual authority to deal with the charged assets comes to an end. In this situation, the chargee will be able to appoint the receiver, to take possession, to sell or to apply for foreclosure.[121]

Crystallization can occur because of number of reasons. These are generally agreed by the security provider and secured party in the security agreement. The agreement may provide for secured party's right to declare that charge has crystallized upon the occurrence of certain stipulated events like default in the performance of the secured obligations, breach of material terms of the security agreement and collateral change in control of the security provider and the like.[122] The agreement may also provide for the automatic crystallization on the occurrence of certain events including but not limited to failure to pay a sum due under the charge within the specified time, judgment against the security provider by other creditor to remain unsatisfied for more than stated period, distress or execution levied against any of its property and external borrowing exceed the specified figure and the like.[123] Crystallization may also occur because of the operation of the law. Ali enlists the events which will trigger crystallization of floating charge by operation of law:

i) "Winding up of the security provider;

ii) Appointment of receiver out of court by the secured party, or by court on behalf of the secured party;

[120] Ali (n 82) 124.
[121] Tajti (n 25) 259.
[122] Ali (n 82) 126.
[123] MckendRick (n 101) 731.

iii) Cessation of security provider's business or disposition of all or substantially all of the security provider's business assets with a view to the cessation of the business; and

iv) Secured party taking possession of the secured property or otherwise exercising a remedy inconsistent with the security provider license to deal with the secured property"[124]

Crystallization affects the relationship between the chargor- chargee and chargee- third parties. As stated above, post-crystallization chargor charge relationship is basically characterized by loss of chargor's license to deal with the charged property. The central question which arises in chargee-third party relationship is the question of priorities of the competing interest in the chargor's property charged with floating charge. This issue arises if the chargor deals with the secured property and grants inconsistent rights in the same assets to third parties.[125] The issue of priority can raise in regard to competing interests arising prior to crystallization and competing interest arising after crystallization.[126] Goode notes that floating charge will be subordinate to the claims of preferential creditors where the crystallization results because of chargee taking possession of the security, appointment of receiver or debtor company goes into winding up.[127] Generally, as project finance transactions prohibit the creation of security interests ahead or *pari passu* by incorporating the restrictive covenant in security agreement, the issue of priority between the third-party may not arise. Nevertheless, this might always not be the case.

It is essential in project finance transactions that the lenders are able to create security over all present and future assets of the project company. English law's fixed and floating charge provides

[124] Ali (n 82) 125.
[125] MckendRick (n 101) 732.
[126] Ibid 732-736.
[127] Ibid 736.

scope for the lenders in the project finance transactions to acquire security interest in present assets via fixed charge and future assets and receivables via floating charge. Security interest through floating charge can be created over any assets and receivables, which however should be identifiable. As noted above, fixed and floating charge are normally combined to create security interest in which fixed charge supplements the floating charge. It is basically to establish control over the asset in which security interest is created. Moreover, management or control function of the security, discussed above in Section 1.2 is very important in context of project finance, floating charge confers this function of security for the lenders in the project finance transaction.

2.2 CREATION OF SECURITY INTEREST IN NEPAL

Secured Transaction Act 2063 (2006)[128] of Nepal incorporates the provisions related to creation of security interests and in relation to movable and intangible property and its enforcement in Nepal. It was enacted on 16 November 2006[129]. Prior to enactment of Secured Transaction Act in 2006, the creation of security including security interests related to movable and intangible property was governed by Country Code of Nepal (Muluki Ain)[130] which was the *lex generalis* and specific laws like Banking and Financial Institutions Act, Contract Act and Regulations published by the Central Bank of Nepal. The preamble of Secured Transaction Act 2006 states that the act was enacted to consolidate the legal provisions related to secured transactions to secure

[128] Secured Transaction Act 2006 <http://www.lawcommission.gov.np/en/archives/category/documents/prevailing-law/statutes-acts/secured-transaction-act-2063-2006> accessed 14 March 2019.

[129] सुरक्षित कारोबार ऐन २०६३ (Secured Transaction Act 2006 in Nepali language) < http://www.lawcommission.gov.np/np/wp-content/uploads/2018/10/%E0%A4%B8%E0%A5%81%E0%A4%B0%E0%A4%95%E0%A5%8D%E0%A4%B7%E0%A4%BF%E0%A4%A4-%E0%A4%95%E0%A4%BE%E0%A4%B0%E0%A4%BE%E0%A5%87%E0%A4%B5%E0%A4%BE%E0%A4%B0-%E0%A4%8F%E0%A5%87%E0%A4%A8-%E0%A5%A8%E0%A5%A6.pdf> accessed 14 March 2019.

[130] Country Code of Nepal is now repealed and replaced two separate legislations i) Civil Code and ii) Criminal Code. Civil Code regulates the matters related to property, security over immovable goods, contracts and private international law, court procedures and the like.

obligations with movable and intangible property in order to ensure maximum promotion of economic activities in Nepal. [131] The Secured Transaction Act among others provides for the provisions related to establishment of registry, creation and attachment of security interest, maturity and priority of security interest and enforcement of security interest.[132]

Secured Transaction Act incorporates the broad definition of ‘security interest’ and ‘collateral’ which gives the scope of creating security over all forms of assets. Pursuant to Section 2(r) of Secured Transaction Act, security interest means a property right in collateral that secures performance of an obligation[133]. This covers all forms of proprietary interest to secure the obligation including monetary and non-monetary. Moreover, Section 2(p) of the Secured Transaction Act defines the collateral as any intangible property of any nature, fixtures, and movable property including collateral arising in future, collateral located in or outside Nepal, accounts, secured sales contracts, leased goods and proceeds of collateral.[134] It is clear form this definition that collateral includes all forms of tangible and intangible assets including inventory, fixtures and future assets.

Likewise, Section 25 of the Secured Transaction Act provides that security interest will be attached to collateral and become enforceable against the chargor and third party only if a) security agreement has been entered into, providing a description of the collateral (b) where the chargee has given value to the chargor and (c) where the chargor has rights in the collateral or the power to transfer such collateral to the security holder.[135] Further, Section 26 of the Secured Transaction Act provides that the security interest gets maturity if among others chargee takes possession

[131] Secured Transaction Act 2006, Preamble.
[132] See Secured Transaction Act 2006.
[133] Secured Transaction Act 2006, Section 2(r).
[134] Secured Transaction Act 2006, Section 2(p).
[135] Secured Transaction Act 2006, Section 25.

collateral with the security interest in goods, instruments, documents or secured sales contracts.[136] It also further provides that such chargee has the option to mature the security interest by filing the notice before, during or after the period of possession.[137] This essentially priorities the importance of possession of the collateral for the security interest to get maturity. Although the Act covers the broad definition of security interest and collateral to cover all kinds of proprietary interest to secure the obligation including pre-existing and future obligations, in the light of provisions of Section 25 and 26, it is clear that the Act does not adopt the concept of floating charge, does not provide for the creation of the security interest in the future assets and requires possession of goods for the maturity of security interest which is not practical in context of project finance and floating charge.

[136] Secured Transaction Act 2006, Section 26.
[137] Ibid.

CHAPTER 3

RIGHTS OF LENDERS IN TROUBLED PROJECTS

Projects in trouble are the projects which are moving toward or is in the financial position that levies a greater financial risk to lenders, claimants and the concerned stakeholder.[138] It also refers to the projects which do not meet the contractual obligations and are in default. Moreover, it can also connote that the project company is in the state of being insolvent or bankrupt. In context of project finance, considering the greater risk that is attached to the success of the projects, risk is spread through the network of security arrangements and contractual arrangement.[139] One of such contractual arrangement is the direct agreement by the lenders with the contractors and sometimes even with the government (in case of concession) which provides project lenders the ability to step in to the shoes of borrower(project company) in the event of default under the project contract.[140] Moreover, the projects in which floating charge is used to create security interest, the lenders have the right to appoint the receiver and take over the control of the project company.[141] Likewise, lenders have the right to take the possession of the security assets, sell the security assets, foreclose the assets if the projects in trouble cannot fulfill its obligations.[142] The purpose of this chapter is to highlight enforcement rights of lenders in the projects which are in trouble. Firstly, it will discuss the enforcement rights of the lenders under Nepalese law and later deal with the rights of lenders under English law focusing on the right of the lender to appoint receiver under floating charge.

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[138] Projects in Trouble and Receivership <https://www.naic.org/cipr_topics/topic_troubled_companies_andrecierhsip.htm> accessed 15 March 2019.

[139] APMG International, 'Project Finance-Benefits and Limitations' <https://ppp-certification.com/ppp-certification-guide/5-project-finance-%E2%80%94-benefits-and-limitations> accessed 15 March 2019.

[140] Sabina Axelsson, 'Project Finance and the Efficiency of Direct Agreements Under Swedish Law – The Treatment of The Debtor's Contracts in Bankruptcy' 5 <https://gupea.ub.gu.se/bitstream/2077/1891/1/200636.pdf> accessed 15 March 2019.

[141] Jan-Hendrik Röver, 'Secured Lending in Commercial Transactions - Trends and Perspectives' < https://www.ebrd.com/downloads/legal/secured/roever7m.pdf> accessed 15 March 2019.

[142] Vinter (n 44) 328.

3.1 ENFORCEMENT RIGHTS OF LENDERS UNDER NEPALESE SECURED TRANSACTION ACT

Secured Transaction Act of Nepal provides for the mechanism to enforce the security interest over the collateral. The Act gives the parties autonomy to select the mechanism to perform their obligation. Section 46 of the Act provides that parties by mutual consent can make necessary provisions on the performance of obligation of the parties. [143] Section 46(2) of the Act provides that the in the event of default in performance of the obligation by the chargor, chargee has the right to take possession or control of the collateral as the chargee prefers even if the security agreement has no provision about possession or control, to sell and dispose of the collateral, to exercise such other rights and remedies as provided in the security agreement and to exercise such rights and remedies as provided under the other laws in force.[144] The Act also provides broad right to the chargee to exercise any or all remedies simultaneously.[145]

i) Right of Lender to take Possession

In the event of default in the performance of obligation, the chargee has the right to take possession or control of collateral without legal proceedings if the chargee has obtained consent from the chargor in writing.[146] If such consent is not obtained, the chargee has the right to take possession or control over the collateral by the order of the court.[147] Further, chargor subject to the security agreement has the right to require the chargor to make the collateral available to the chargee at a place to be designated by the chargor. Moreover, pursuant to the

[143] Secured Transaction Act 2006, Section 46(1).
[144] Secured Transaction Act 2006, Section 46(2).
[145] Secured Transaction Act, Section 46(3).
[146] Secured Transaction Act, Section 48.
[147] Ibid.

Act, chargor has the right to declare the asset unusable and right to dispose the collateral at the place of business of the chargor or the place where the collateral is located.[148]

ii) Rights of Lenders to Sell and Dispose of Collateral

In the event of default in the performance of obligation, a chargee has the right to sell, lease or dispose of any or all of the collateral.[149] Such disposal and sale should be sold and disposed as a single unit or in package at any time and place publicly or privately subject to the security agreement.[150] Nevertheless, chargee has to give chargor a reasonable notice of time and place where sale or disposal is proposed.[151]

In addition to these, lenders have the right to seek the court order (restraining order) to prevent interference with the enforcement rights of the lenders and require the chargor to hand over the possession of the collateral if the chargor tries to prevent or interfere with the enforcement of security interest i.e taking possession, sale or disposal of the collateral contrary to the provisions of the security agreement.[152] Secured Transaction Act of Nepal defines the act which constitute the interference with the enforcement rights of the lenders which includes damage of the collateral and wrongful transfer of the collateral.[153]

It is important to note that the lender and borrower, pursuant to Secured Transaction Act, can agree to any kind of enforcement mechanism. It means that lenders and borrower can also agree on the rights of the lender to step in and obtain the control in case of default of obligations. This is however, not clearly stated by the Act. Nevertheless, incorporation of

148 Ibid.
149 Secured Transaction Act, Section 50.
150 Ibid.
151 Ibid.
152 Secured Transaction Act, Section 49.
153 See Secured Transaction Act, Section 49.

Section 49 (Right available to the Lenders in case interference by Borrower with the enforcement of security interest) also gives the lenders to use the agreed enforcement mechanism in conjunction with the right provided in Section 49 of the Act.

As noted in Section 2.2, Secured Transaction Act does not adopt the concept of floating charge, therefore, the flexibility incorporated above in relation to the enforcement mechanism is hardly of use without recognition of the floating charge as the right to appoint receiver is essentially attached to concept of floating charge.

3.2 ENFORCEMENT RIGHTS OF LENDERS UNDER ENGLISH LAW

Under the English law, secured creditors can enforce security in accordance with the terms provided in the security agreement, which is generally the event of default.[154] Events of default include but are not limited to non-payment of the secured obligation, insolvency events and breach of the financing agreement.[155] Vinter *et al* note that the enforcement rights that are available to secured creditors in Project Finance under the security which is governed by English Law are[156]

i) To take possession of the security assets

ii) To sell the security assets

iii) To foreclose on the assets (i.e transfer title to secured creditor outright)

iv) To appoint a receiver over the security assets.

In addition to these, security over contractual rights and receivables are enforced against the borrower by exercising the contractual rights and requiring them to make payments directly to the

[154] Practical Law Company, Practical Law Multijurisdictional Guide 2012: Finance, <https://www.slaughterandmay.com/media/1761044/plc-finance-multi-jurisdictional-guide-uk-chapter.pdf> accessed 15 March 2019.
[155] Ibid.
[156] Vinter (n 44) 328.

lender.[157] Moreover, if lender have direct agreement lender has the right to step into the shoes of the project company and also theoretical right to transfer the project company's property or assets.[158] Under the English Law, taking possession of security assets, sale of such security and appointment of receiver in general do not require court order but there is the need of court order to foreclose the security assets.[159] Vinter *et al* note that these rights give lender range of options if lenders want to take over control of the project. Taking possession of land or physical assets is less attractive in case of project finance for the lenders but taking possession of intangible property like bank accounts and receivables.[160]

3.2.1 DIRECT AGREEMENT AND LENDER'S RIGHT TO APPOINT RECEIVER

In project finance, direct agreement is the agreement entered between the project company, financer of the project and parties to the project's key commercial contracts.[161] The key contracts for this purpose would typically include the concession agreement, the main construction contract, any operation and maintenance agreement, any long-term supply contract and any long-term sales contracts.[162] Delmon notes that direct agreement between lenders, sponsor and project participant typically provides for step in regime and it can involve three different levels of lender intervention in the project: cure rights, strict step in rights and novation or substitution.[163] He, however, notes that cure rights and novation or substitution are not pure step in rights and clarifies that step-in

[157] Practical Law Company (n 154).
[158] Ibid.
[159] Vinter (n 44) 328.
[160] Ibid.
[161] Ibid 307.
[162] Axelsson (n 140) 4.
[163] Jeffrey Delmon, *Private Sector Investment in Infrastructure: Project Finance, PPP Projects and Risk* (2nd ed, Wolters Kluwer Law and Business 2009) 81.

right arises where a "project company breaches one of the project documents and the relevant project participant chooses to terminate. "[164]

Vinter *et al* , in a similar line, argue that direct agreement is used in project finance to enable financiers of the project to 'step in to the shoes" of the project company if the borrower defaults on its obligation or if the project contract related to the direct agreement is terminable.[165] The agreement provides right to the financer to assume the project company's rights and obligations under the contract for a specific period or allow the transfer of the contract to a separate company established by financers for this purpose.[166] This allows the financers to seize the control of project company's right under project contract and also protects financiers against the termination of the project contract.[167]

Vinter *et al* note that direct agreement can connote two different types of transfer of project contract. First, the agreement which provides that if the financer receive prior notification from the third parties in the project before third parties take hostile action against the project company, financers/lenders give a counter notice to the third parties, third parties then allows to lenders to assume project company's rights and obligation (i.e step into the contract) through the appointment of receiver or similar agent appointed by them and then if necessary subsequently "step-out" of the contract.[168] Second, the agreement which provides for the procedure to permanently transfer the contract to the substitute which is proposed by the lender.[169] Considering Vinter *et al*'s description of the meaning of the direct agreement and the rights arising there off, it can be noted

164 Ibid.
165 Vinter (n 44) 307.
166 Axelsson (n 140) 4.
167 Vinter (n 44) 307.
168 Ibid.
169 Ibid.

that direct agreement also provides for the scope where that the lenders can appoint receiver to assume project company's rights and obligation.

3.2.2 RIGHT TO APPOINT THE RECEIVER UNDER THE FLOATING CHARGE

English Law provides the scope to secured lenders in project finance with qualifying floating charge to appoint the receiver over the project's business and assets to run the business with a view to repay amount due to the lender.[170] It is stated that the early roots of receivership can be found in the practice of mortgagee's right to take possession of the mortgaged property where mortgagor defaulted under the loan agreement.[171] Mortgage taking over the possession was regarded as a bold assertion of legal rights and the courts of equity asserted that mortgagees in possession had the duty to so as to ensure that a mortgagee dealt fairly and equitably with the mortgagor.[172] With this mortgagee began to insist on a contractual provision requiring the mortgagor to appoint a receiver at the request of the mortgagee but on the basis that the receiver would be the agent of the mortgagor.[173] Receivership, therefore, developed as the contractual remedy and the parties agreed the rights and duties of the receiver. This concept was then developed as a means to repossessing the land or selling the land and its yield.[174] The concept was later used for the benefit of the creditor who financed the business and adapted together with floating charge to charge both immovable and movable assets against the loan to the company.[175]

It was noted by Jenkins L.J. *In Re B. Johnson & Co. Builders* that a receiver is given powers of the management to enable to preserve and realize the assets which comprised in the security for

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170 Ibid 270.

171 Ian McDonald and Danny Moujalli, 'A very English concept: the receiver appointed out of court' (2001) 14(10) Insolv. Int. 76, 76.

172 Ibid.

173 Ibid.

174 Harry Rajak, 'Enterprise and Fall of Receivership' <http://siteresources.worldbank.org/GILD/Resources/2_1_Rajak_EBRDAttachment1.pdf> accessed 16 March 2019.

175 Ibid.

the benefit of debenture holder.[176] To support Jenkins L.J's opinion, Lawrence Collins notes that the function of receiver in general was to receive or recover the assets of the company and, to carry on the business of the company with a view to realization of the value of the charged security.[177] Receivership continued to exist in the form of administrative receiver even when the concept of administration was introduced by the Insolvency Act. Before entering into the changes to receivership brought by Insolvency Act in England by introducing the concept of administrator administrative receivership, it is noteworthy to discuss the differences between receiver and administrative receiver.

In England, receivership was basically governed by contract law and court ruling.[178] Receivership was therefore, essentially private-law contractual nature. Receivers and managers were appointed under the terms of debenture/agreement without recourse to the court.[179] Receivership was the remedy which was used for the enforcement of secured debt by a charge over the property. Secured lender with debenture or floating charge could appoint receiver or manager under the receivership if the borrower failed to repay the secured debt.[180] Appointed receiver and manager could take possession of the property which constitutes the security and later either sell the property or collect the profits accrued from the project to satisfy the secured debt.[181]

Administrative receiver, on the other hand, is also of private-law contractual nature.[182] However, the appointment of administrative receiver is regulated by the statutes especially Insolvency Act 1986 and Enterprise Act 2002. Section 29(2) of the Insolvency Act defines administrative receiver

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176 Lawrence Collins, 'Floating Charges, Receivers and Managers and the Conflict of Laws' (1978) 27(4) The International and Comparative Law Quarterly 691, 692.
177 Ibid.
178 McDonald (n 171) 76.
179 Ibid.
180 Ibid.
181 Ibid.
182 Ibid.

as “a receiver or manager of the whole (or substantially the whole) of company’s property appointed by or on behalf of holders of any debentures of the company secured by a charge which as created was floating charge, or by such a charge and one or more other securities.”[183]. The sole criteria for the appointment of the administrative receiver, pursuant to the act, was that the security should be granted over all or substantially all of the company’s property through floating charge. This gave the scope for the secured lender with floating charge to block the appointment of administrator and right to appoint an administrative receiver in the situation of default or if project is in trouble.

Armor and Frisby note that secured creditor with floating charge could confer the right to appoint the administrative receiver without any precondition of demand for repayment being made if such clause was incorporated in the financing documents.[184] They further state that such appointment could be immediate without giving borrower’s directors opportunity to seek alternative finance and without considering the interest of the borrower company or its unsecured creditor.[185] Moreover, they note administrative receivership is means through which secured creditor with floating charge is entitled to two types of right i) right to control the collateral and ii) right to be paid out of the assets in priority to unsecured creditor.[186] Therefore, administrative receiver has the duty to exercise the powers in the interest of secured lender in a bona fide manner and to secure the best outcome for their appointor.[187] Nevertheless, the administrative receiver has the duty of care and skill to borrower company and the remaining creditors of a company.[188] Although secured creditor can appoint the administrative receiver without considering the interest of borrower

[183] Insolvency Act 1986, s 29(2).
[184] John Armour and Sandra Frisby, ‘Rethinking Receivership (2001) 21(1) Oxford Journal of Legal Studies 73, 76.
[185] Ibid.
[186] Ibid 87.
[187] Ibid 77.
[188] Ibid.

company, statutorily such administrative receiver is borrower company's agent unless it goes into liquidation.[189] The administrative receiver has the wide range of powers to mange borrower company's business, to commit new contracts, to control, sell the asset and may also cause the company to breach the pre-appointed contracts in order to further the interests of debenture holder.[190] Armor and Frisby note that in receivership board of directors are unable to govern receiver's action as a result of which company is displaced from decision making in relation to its property.[191] Hence, it is clear that third parties and junior creditors have little or no input in this receivership process. Ian McDonald and Danny Moujalli enlist wide range of powers which the receiver could exercise in the interest of the secured creditor who appointed him/her which are[192]:

1. "To assist the secured creditor in obtaining payment of secured debt by taking possession of and collecting the property charged in favour of secured creditor;

2. To act in the interest of secured creditor by making arrangements and/or compromises on behalf of the borrower company. This power can extend to litigation based on disputes which arose before the appointment of receiver;

3. To carry on or manage the business of the borrower company for the purpose of generating profits from which the secured debt/obligation can be discharged;

4. To carry on the business of the borrower company by raising or borrowing money on the security of the mortgaged property;

5. To sell the mortgaged property;

[189] Ibid.
[190] Ibid 78.
[191] Ibid.
[192] McDonald (n 171) 77.

6. To do reasonably necessary for or incidental to the secure the interest of the secured creditor."

Because of this wide power which the receiver could exercise in the troubled company, there was popular perception that administrative receiver and their appointer (secured creditor) held too much power which was detriment to other stakeholders of the borrower.[193] Moreover, receiver's perverse incentive to close down the business too quickly in case of assets where the value of assets subject to its charges is greater leaded to such perception.[194] This led to the introduction of changes in the Insolvency Act by removing the right of secured creditor with floating charge to appoint an administrative receiver of the borrower company. Section 250(1) of the Enterprise Act 2002 amended the Insolvency Act 1986 which removed the right of the secured creditor with the floating charge in respect of company's property to appoint administrative receiver of the company. Nevertheless, Section 72 of Insolvency Act 1986 allows administrative receiver to be appointed in certain exceptional cases which includes:[195]

i) Certain capital market arrangements;

ii) Public private partnership projects;

iii) Utility projects;

iv) Lager project financings;

v) Arrangements made in financial markets;

vi) Registered social land lord;

[193] Armour (n 184) 73.
[194] Rizwaan Jameel Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005) 213.
[195] See Insolvency Act of England, Section 72.

vii) Protected railway companies, water and sewerage undertakers and air traffic license holders.

Appointing administrative receiver in the context of project finance was exempted owing to the fact that the companies which are financed are generally special purpose vehicle with almost none unsecured creditor[196] and also financing done through project finance restricts such project companies to obtain debt or grant security interest to project company's assets to other creditors. Moreover, exemption in the context of project finance was also agreed in consideration of the argument that loss of right to appoint administrative receiver would result in higher price for the securitization in project finance, obtaining project loans for project companies and make it difficult to raise investment for public infrastructure.[197]

3.3 PROJECT FINANCE, FLOATING CHARGE AND RIGHT TO APPOINT RECEIVER

As noted above in 1.1 above, security in project finance has the defensive role and it helps the secured lender to exercise the control over the management of the borrower if security interest is created through floating charge. The major role of the security in project finance is achieving the management purpose in case of default in obligations exercisable by appointing receiver. Recognizing the importance of obtaining control and achieving the management purpose, in project financing, project financing and other related projects were enlisted in the exemptions where the administrative receivers could be appointed.

Precisely, Section 72(E) of the Insolvency Act 1986 provides that appointment of administrative receiver of a project company is not prohibited if it is the financed project and includes the step in rights. Section 72(E) clarifies that a project is "financed" if project company pursuant to the

[196] Vinter (n 44) 291.
[197] Ibid.

agreement incurs or will incur debt of at least £50 million in order to undertake particular project. Likewise, Insolvency Act clarifies that the company is the project company if i) it holds property for the purpose of the project ii) it has sole or principal responsibility under an agreement for carrying out all or part of the project iii) it is one of a number of companies which together carry out the project iv) it has the purpose of supplying finance to enable the project to be carried out, or v) is the holding company of the companies which undertake aforementioned activity.[198] Moreover, pursuant to the Insolvency Act the rights constitute step in rights if a person/entity who provides finance to the project has the entitlement to assume sole or principal responsibility under an agreement for carrying out all or part of the project. [199] However, Insolvency Act does not define what constitutes the project.

The exception to appoint administrative receiver provided in the context of project finance is an example that receivership is the best way for the financers in the project finance transactions to control project company and if necessary deploy and use project company's assets and receivables such that the project company's secured obligations are fulfilled. Moreover, it also the instance which notes that receivership in the context of project finance secures the interest of secured creditor from the claims of the unsecured creditor.

Feetum v Levy[200] is one of the key cases which has discussed the appointment of administrative receivers by the floating charge holder, the exceptions to appointing administrative receivers, meaning of "project" for the purposes of the project finance exception and the like. *Feetum v Levy* will be discussed in the following as it provides insights in relation to receivership in the context of security created through floating charge in Project Finance. In *Feetum v Levy*, court denied the

[198] See Insolvency Act 1986, Schedule 2 A, para 7.
[199] See Insolvency Act 1986, Schedule 2 A, para 6.
[200] [2005] EWHC 349 (Ch).

holder of the floating charge in the company's property from appointing administrative receiver pursuant to Insolvency Act 1986 as none of the exceptions provided in section 72 of the Insolvency Act could not be fulfilled or met in the case.[201]

In *Feetum v Levy*, Cabvision Limited (Defendant) appointed administrative receivers in a limited liability partnership called Tower Taxi Technology LLP (Claimant) pursuant to the debenture dated 5 April 2004.[202] Cabvision appointed administrative receiver with the belief that debenture was the qualifying floating charge and the exemption provided in the Insolvency Act 1986 applied to the appointment. The question which the court decided in this case was whether the floating charge in Tower Taxi Technology LLP was within the scope of exception of Project Finance provided in Insolvency Act and whether the appointment of administrative receiver was valid. Cabvision had to show that Tower Taxi Technology LLP was the project company of a project, that the project was a financed project, and that the project included step-in rights to be eligible for the exception.[203]

Tower Taxi Technology LLP was incorporated for the purpose of acquisition of the software called ICT software which related to Cabvision system which involved installation of screens in taxicabs to present video and sound to passengers.[204] Tower Taxi Technology LLP entered into agreement with Cabvision Limited on 5 December 2003 which granted Tower Taxi Technology LLP exclusive royalty free license to use the Cabvision system in 10,000 taxi cabs for the term of agreement and on the same day, Tower Taxi Technology LLP issued information memorandum inviting investment in it with the expectation 25% of the fund would be funded by subscription

[201] Case Digest, *Feetum v Levy*, [2005] EWHC 349 (Ch).
[202] [2005] EWHC 349 (Ch) 1.
[203] Ibid 7.
[204] Ibid 3.

from its investor and remaining 75% by the bank loan.[205] The information memorandum issued by Tower Taxi Technology LLP assumed that it would obtain £90 million out of which £22.5 million will come from subscription and £67.5 million from the bank loan but due to less subscriptions it could only attract £6.7 million in subscription and it requested drawdown pursuant to the facility agreement entered with Lloyds Bank £20.3 million.[206] Cabvision provided security for the bank loan by taking a counter-indemnity from Tower Taxi Technology LLP which was supported by debenture; the debenture incorporated the provision which created floating charge and provided Cabvision right to appoint an administrative receiver over Tower Taxi Technology LLP's charged property and undertaking if an event of insolvency occurs.[207] On 3 December 2004, Cabvision appointed Levy and Berman as the joint administrative receivers of Tower Taxi Technology LLP against which Board of Directors of Tower Taxi Technology LLP challenged the validity of appointment and sought declarations that the appointment was invalid.[208]

In deciding whether Tower Taxi Technology LLP was the project company of a project, that the project was a financed project, and that the project included step-in rights to be eligible for the exception, the court discussed the meaning of project, financed project and step in rights.

Tower Taxi Technology LLP's counsel argued that "project" should be interpreted as described in Wood on Project Finance i.e "Under project finance, banks provide finance for a single project and take a large part of the risk of success or failure of that project. The project may be an oil and gas field, a mine, a mobile telephone or cable network, a toll tunnel, bridge or highway, a refinery, power station or pipeline, or offices or shops or any other venture involving construction or

[205] Ibid 3-4.
[206] Ibid 4.
[207] Ibid 6.
[208] Ibid 1.

engineering. The amount of finance required for large projects may run to several billion US Dollars."[209] for the context of Section 72E of the Insolvency Act 1986. The Court noted that the definition of the project should not be restricted to ventures involving construction or engineering and stated that scheme promoted by Tower Taxi Technology LLP is a project within the meaning of Section 72E.[210]

Likewise, Court interpreted term "financed" in the context of the context of Section 72(E) of the Insolvency Act 1986. Section 72(E) of the Insolvency Act clarifies that a project is "financed" if project company pursuant to the agreement incurs or will incur debt of at least £50 million in order to undertake particular project.[211] In this case, the debt involved was less than £50 million but it was argued that company expected to borrow up to £65 million which in the view of the court did not meet the requirement or threshold set in Section 72(E) of Insolvency Act. Therefore, court noted that the exemption in Section 72(E) does not apply.[212]

Moreover, the Court also discussed "Step in rights" in context of Section 72(E) of the Insolvency Act 1986. The Court noted that contractual entitlement to appoint receivers under debenture would not constitute step in rights.[213] It noted that the decision by the administrative receiver to carry on the project would not in law be the decision of Cabvision.[214] It further noted that owing to the debenture, receiver appointed by Cabvision had the power to act on behalf of Cabvision but it was limited to receiver's discretion.[215] The Court, therefore, decided that the project is not one in which there are step in right taking into the consideration that Cabvision failed to show that it had "step-

[209] Ibid 7-8.
[210] Insolvency Act 1986, Section 76(E).
[211] Ibid.
[212] Ibid 11.
[213] Ibid.
[214] Ibid 11-12.
[215] Ibid 12.

in rights" in the sense of an entitlement to make arrangements for carrying out all or part of the project. [216]

Hence, the court held that the receivers had not been validly appointed as only one of the three conditions required by Section 72(E) of the Insolvency Act had been fulfilled. The decision of the Court is helpful in interpretation of Section 72(E) of the Insolvency Act and illustrating that interpretation of the term “project” in context of Section 72(E) should not restricted. Moreover, it also highlights that there must be genuine establishment that the debt of £50 million or more is / will be incurred. It also clarified that effective contractual step in rights enforceable by the financer must be created and mere fact that lender/financer could appoint receiver was not sufficient for the lenders to exercise step in right in the context of project finance.

Feetum v Levy clarified that in the context of using exemption provided in Section 76(E) of the Insolvency Act, the conditions stipulated in the Act must be strictly met. Absence of one the conditions set in the Act makes the holder of the floating charge ineligible to appoint administrator in projects financed through project finance. Moreover, Court’s interpretation of the term “project” has made it clear that the project finance transactions is not only limited to construction or engineering, but it can also extend to any other kinds of projects. The only exception to this is that the finance should be at least of £50 million. The Court has made clear through this case any project in which lenders have financed at least £50 million can use the exemption provided in the Act provided that the lenders have the step in rights. Likewise, Court’s unwillingness to accept mere right to appoint administrative receiver as step in right gives important lesson that in the context of project finance direct agreement or other similar contractual arrangement has an important role to stipulate the step in rights of floating charge holder. Comment by Graham D.

[216] Ibid.

Vinter that “prudence dictates that it will be better for lenders to be rather more expansive about the arrangement they have in place for carrying out the project (as would normally be the case in the typical direct agreement)”[217] indeed, seems to be correct in the context of using exemption of project finance provided in the Insolvency Act. Furthermore, the case also noted that lenders should not be limited to the discretion of administrative receiver to exercise step in rights which is indeed a lesson that the contractual arrangement to appoint administrative receive should clearly provide that administrative receiver should act for and in the interest of lenders with floating charge with the duty of care towards borrower.

[217] Graham D. Vinter, *Project Finance: A Legal Guide* (3d ed, Sweet and Maxwell 2006) 263.

CONCLUSION

The introduction of Secured Transaction Act in Nepal in 2006 consolidating scattered provisions related to creation of security interests in movables and intangible is a breakthrough in the context of promoting secured lending for enhancing economic activities in country like Nepal. The hype in the project finance transactions particularly in the construction and operation of hydropower and cement plants was among others one of the major reasons for the introduction of Secured Transaction Act 2006. Therefore, expectation of lenders in project finance transaction in relation to Secured Transaction Act 2006 is that the act provides for the provisions and mechanisms which meets the interest of Project Finance lenders. The Secured Transaction Act 2006, however, does not incorporate provisions related floating charges, the possibility of the appointment of receivers and step in rights, which are the essential components for the functioning of the project finance.

Secured Transaction Act 2006 provides broad definition of security interest and collateral which gives scope of creation of security interest over all kinds of assets including intangible property, movables, fixtures, accounts and its proceeds and assets that can arise in future. However, the requirement of description of the collateral in the security agreement for the security interest to be attached to collateral and be enforceable is clearly exemplifies that the Act does not accept floating charge as one of the ways to create security interest in Nepal. Similarly, the requirement of possession of the goods for the maturity and enforceability of the security interest is also another instance which shows that Secured Transaction Act rejects the concept of floating charge.

In addition to providing the conventional enforcement mechanism like taking possession, sale and foreclosure, Secured Transaction Act, also provides for flexible mechanism in which secured lenders and borrower can agree on the enforcement rights of the security interest of the lenders. One can assume that this flexibility can ensure that the lenders and borrower can agree on the step in rights of the lenders including the right to appoint receiver in project finance. Nevertheless, it has to be noted that appointment of such receiver will be hardly of use without the concept floating charge with the Act. Therefore, the silence of the Secured Transaction Act in relation to floating charge and the right to appoint receiver has made lenders and borrowers less confident to agreeing on the exercise of step in rights including right to appoint receiver. Secured Transaction Act in the context of Project Finance might have not incorporated concept of floating charge and the right to appoint receiver as the step in right because Secured Transaction Act of Nepal was largely influenced by the UCC Article 9.[218] However, these inadequacies must be resolved by learning from the English experience where the concept of floating charge and right to appoint receiver in the context of Project Finance was retained despite the significant having changes in the regime of receivership in other sectors.

It is clear from the discussion made above that lenders use fixed charge and floating charge in Project Finance transactions as these charges encumber all present and future assets and receivable of the borrower. Lenders use fixed charge and floating charge to obtain priority over the junior lender or unsecured lender and obtain the control over the borrower in case of borrower fails to meet its obligation or it is trouble/financial difficulty, in which priority is ascertained by former and control is ascertained by later. As noted by Vinter *et al* direct agreement and step in rights in the context of project finance provides for the mechanism where lenders can assume project company's rights and obligations through the appointment of receiver. Moreover, it is also noted that in rights are almost synonyms to appointing receiver with concrete contractual arrangement. In this sense, direct agreement and step in right set out in the agreement is practically the right to

[218] James D. Hekel, 'UCC comes to Nepal' < http://jameshekel.com/index.php/2015/10/10/the-ucc-comes-to-nepal-part-ii/> accessed on 20 March 2019.

appoint receiver by the holder of the floating charge. Hence, it is clear that in the context of project finance, floating charge is the easy and effective way achieving the control or the management purpose as it gives the lenders the right to appoint the receiver.

Project finance transactions are volatile in which the risks of transactions are allocated and assigned through contractual arrangement. Lenders, in project finance transactions, bear a great risk by financing the project based on the collateral limited to the assets of the project and projected future cash flow of the project company and guarantee provided by the project sponsors because loans issued to the project company is not proportionate to the recovery in case of default. Floating charge and the right to appoint receiver, in the context of project finance transactions, is assurance to the lenders that in case of default they have the right to step in to the shoes of project company, take the control, manage the project, ensure its completion and step out of the project when borrower is able to meet its secured obligations. Floating charge and the appointment of receiver in project finance, therefore, ensures efficiency in the enforcement of the security interest.

English law retained concept of floating charge and receivership in the project finance transaction amid the ongoing debate about abolishing floating charge and receivership owing to the benefits it renders in successful completion of the projects through step in right exercised by the lenders via the appointment of receiver and efficient enforcement of the security interest. This is an important lesson for Nepal that floating charge and receivership is the best available options which assures completion of project financed via project finance meeting the interest of all stakeholders connected to the project.

Moreover, interpretation of terms "project", "financed project" and "step in rights" made by court in *Feetum v Levy* is also an important lesson for Nepal. As noted by the court, Nepal should also take into consideration that projects in the context of project finance may not be limited to construction or engineering. Similarly, requirement of strict monetary threshold to exercise step in right by appointing receiver is also the issue which will be of concern if Nepal makes changes in Secured Transaction Act by introducing floating charge and receivership. Likewise, court's interpretation that mere appointment of receiver is not equivalent to step in right required by the English act also necessitates that in addition to the appointment of receiver special contractual arrangement stipulating special provisions about step in rights of lenders is essential.

Hence, it is evident that floating charge and receivership ensures completion of the projects financed via project finance and is project finance friendly way of enforcing security interest. Therefore, based on the foregoing analysis about Project Finance, risks in built in project finance transactions and English experiences, the of concept of floating charge and receivership can be important method to ensure successful completion and running of projects financed via project finance in Nepal.

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