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Kabazzi Maurice Lwanga

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LEGAL RISKS OF PROJECT FINANCE IN UGANDA

*Kabazzi Maurice Lwanga**

ABSTRACT

Although project financing, typically used for funding government projects, is advantageous in infrastructure investment, there are legal issues and risks that are common to most projects in Uganda. By and large, this exposition describes some of the possible legal and regulatory risks of infrastructure projects by private sponsors. This paper examines the applicability of PF to private projects and determines whether PF for private sponsors passes the legal muster. Upon discussing the legal challenges involved in PF, it highlights some mitigating mechanisms/due diligence approaches to counter these legal risks in the Republic of Uganda.

1.0 INTRODUCTION

Project finance refers to the "financing of the construction or development of a project where the lenders rely primarily on the expected cash flow generated by the operation of the project for repayment of their loans as well as for the value of the project's assets".[1]

Multi-billion projects by private sponsors have benefitted from Project Financing (PF) in Uganda. For example, the Sukuru phosphate project, by a private sponsor was launched in Tororo district with financing from the Industrial Commercial Bank of China.[2] Such project-financed transactions

* LLB IV Student LLB 4 Student, Makerere University Law School. With acknowledgement to Sarah Kisubi Esq of Kalenge, Bwanika, Kisubi & Co. Advocates whose insight on Project Finance has sparked my interest in this legal field. With thanks to Makerere Law Journal Editorial Board for their careful input to make this research palatable.

[1] Harold Moore/Evelyn Giaccio, 'International Project Finance', North Carolina Journal of International Law and Commercial Regulation 11 (1987), 597–612, at 597–598.

[2] "Industrial and Commercial Bank of China (ICBC) in cooperation with the Standard Bank Group will disburse the money in tranches to Guangzhou Dong Song Energy Group Company Ltd which is the project developer", <https://www.newvision.co.ug> [Accessed 5 March 2022]

by requested by private sponsors include capital-intensive infrastructure projects, facilities and utilities is a long-term debt.[3]

Project finance is also conceived to be the financing of the development or exploitation of a right, natural resource or other asset where the bulk of the financing is to be provided by way of debt, and is to be repaid principally out of the assets being financed and their revenues. The project company is typically a special purpose vehicle and lenders have limited or no recourse to sponsors in circumstances where the project is underperforming.[4]

To determine project finance suitability to private infrastructure projects,[5] the risk allocation and mitigation of the legal risks involved is a paramount concern.[6] Private infrastructures include construction of a hotel, university, private hospital, power station, industrial plants, and mill plants among other sectors such as leisure, mining, petrochemicals, and telecoms/satellites.

With a view to mitigating legal and regulatory risks, this exposition describes these challenges are likely to weaken the financial returns of investors and creditors. That notwithstanding, project finance is a viable alternative to other financings of investment, that can be boosted when possible ways to mitigate project risks are established.[7]

The essence of any project financing is the identification of all key risks associated with the project and the apportionment of those risks among the various parties participating in the project.[8]

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3 "*Financing Long Term Debt,*" <https://www.ncsc.org> [Accessed 5 March 2022]

4 "*COVID-19 and its Impact on Project Finance Transactions*" <https://www.nortonrosefulbright> [Accessed 5 March 2022]

5 On the other hand, Investment projects handled for government in a range of sectors include transport (for example. roads, railways, airports, light trail), energy (generation and distribution), environment (for example., water and wastewater treatment and distribution) and social infrastructure (for example., hospitals, schools, government buildings).

6 "*Lessons of Experience No. 7: Project Finance in Developing Countries*", available at: <https://www.ifc.org/wps> [Accessed 5 March 2022]

7 Ibid.

8 "*Risk Allocation Bankability and Mitigation in Project Financed Transactions*" <https://ppp.worldbank.org> [Accessed 25 February 2022]

In the Republic of Uganda, project agreements with private investors (sponsors) are typically governed by Ugandan law.[9]

Project finance offers some advantages. Project sponsors are able to shift market risk from companies back to the buyers of the project's output.[10] It is an efficient way to finance large infrastructure projects, that might otherwise be too expensive or speculative to be carried on a corporate balance sheet. This form of financing is primarily based on the strength of the projected cash flows of the SPV.[11]

The goal of this Article is to determine whether project finance can be structured for private investment and thus, highlight ways of protecting project success from legal risks.

Project finance has proved a very powerful tool for financing around the globe over the last decades.[12] According to Young, projects that are able to raise funding can do so only with more stringent conditions, such as lower debt/equity ratios, shorter tenors and more conservative structures.[13] To ensure continuous operations, project financed private infrastructures are subjected to strict compliance procedures and due diligence mechanisms.[14]

The bank's two main objectives are a constant cash flow and a continuous operation of the project. To realize these goals, the lenders must use

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9 In contrast, project agreements for government infrastructures are entered into pursuant to the Public Private Partnerships Act 2015

10 "*What is Project Finance?*", <https://www.businessperspectives.org> [Accessed 10 January 2022]

11 "Project finance" is a term used to reference a model of private financing, where the repayment of financing funds is mainly dependent on the financed project itself. It is the financing of a particular economic unit in which the lender is satisfied to look initially to the cash flows and earnings of that economic unit as the source of funds from which a loan will be repaid and to the assets of the economic unit as a collateral for the loan.

12 Dario Scannapieco, Scannapieco's Foreword to Stefano Gatti, "*Project Finance in Theory and Practice: Designing, Structuring and Financing Private and Public Projects*" Xviii, Xxiii (2nd Ed. 2012)

13 Grace Chinyere Young, "*Understating the Legal Fundamentals of Project Finance Contracts*", *Nnamdi Azikiwe University Journal of International Law and Jurisprudence* <https://www.ajol.info/index.php/naujilj/article/view/> [Accessed 5 March 2022]

14 Ibid.

contractual documents to guard against any potential litigation, legal risks and liabilities.[15]

Legal risks refer to damage or any loss incurred to a project due to negligence in compliance with laws related to the project. The lender is the person who bears the risk of the project company's failure to fulfil the project, thus it is safe to conclude that the lender always needs a proper structure for its protection strategy.

Without a detailed analysis of these project risks at the outset the parties would not have a clear understanding of what obligations and liabilities they may be assuming in connection with the project and, therefore, will not be in a position to consider appropriate risk mitigation exercises at the appropriate time.[16]

2.0 Project Financing versus Lease Financing, Corporate Financing and Loan Financing

Project finance is distinguished from other modes of financing, 'in which the general assets of a sponsoring company, often owning several projects, are wholly or in part the subject of claims by the lender in the event of a failure to repay the loan.[17]

Young referred to a project agreement as a form of loan contract.[18] It should be noted, that it is peculiar in the sense that the lender looks to the economic value and possible cash flow of the intended project as collateral for loan and the source of loan repayment rather than placing liability on the borrower.

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15 "*Risks Associated With Investing in Project Financing Structures,*" <https://paretosec.com> [Accessed 5 March 2022]

16 *"A Guide to Project Finance,"* <https://www.dentons.com/~/media/> [Accessed 9 March 2022]

17 Sheldon Leader, "*Project Finance and Human Rights*", in Juan Bohoslavsky/Jernej Cernic (eds), "*Making Sovereign Financing and Human Rights Work*" (London: Hart Publishing 2016), 199–212, at 200 cited by Diane Desierto, "Due Diligence in World Bank Project Financing," *https://kellogg.nd.edu/sites/default/files/*> [Accessed 4 April 2022]

18 Grace Chinyere YOUNG, "Understating the Legal Fundamentals of Project Finance Contracts, *Nnamdi Azikiwe University Journal of International Law and Jurisprudence,"* <https://www.ajol.info/index.php/naujilj/article/view/> [Accessed 7 December 2021]

Corporate financing on the other hand entails funding a group or existing corporate entity with a strong balance sheet and the main recourse is on the corporate entity. Traditional finance is corporate finance, where the primary source of repayment for investors and creditors is the sponsoring company, backed by its entire balance sheet, not the project alone. Project finance contrasts with regular corporate financing that relies on the strength of the project company or sponsor balance sheet in determining whether to lend to the project under consideration.[19]

In corporate finance, if a project fails, its lenders do not necessarily suffer, as long as the company owning the project remains financially viable. In project finance, if the project fails, investors and creditors can expect significant losses. If the project fails or the expected income stream fails to materialize, the liability for the repayment of the loan does not pass to the project sponsors or operators— except to the extent expressly assumed by them.[20]

Project finance loans are made on a non-recourse or limited recourse basis, whereas lenders normally assess a loan proposition based on the creditworthiness of the borrower reflected by his asset portfolio and aggregate earning capacity, the lender in project finance is willing to look primarily to the expected income stream of the project for his repayment.

2.1 Project finance: Characteristics and Efficiencies

There are five distinctive features of a PF transaction.

First, the debtor is a project company, special purpose vehicle (SPV), that is financially and legally independent from the sponsors, i.e., project companies are standalone entities.

Second, financiers have only limited or no recourse to the sponsors; the extent, amount and quality of their involvement is limited. Lenders, financial

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[19] "*Project Finance and Infrastructure Development: The impact of Tax on Project Bankability*," <https://cristaladvocates.com/?mdocs-file=22087> [Accessed 5 March 2022]

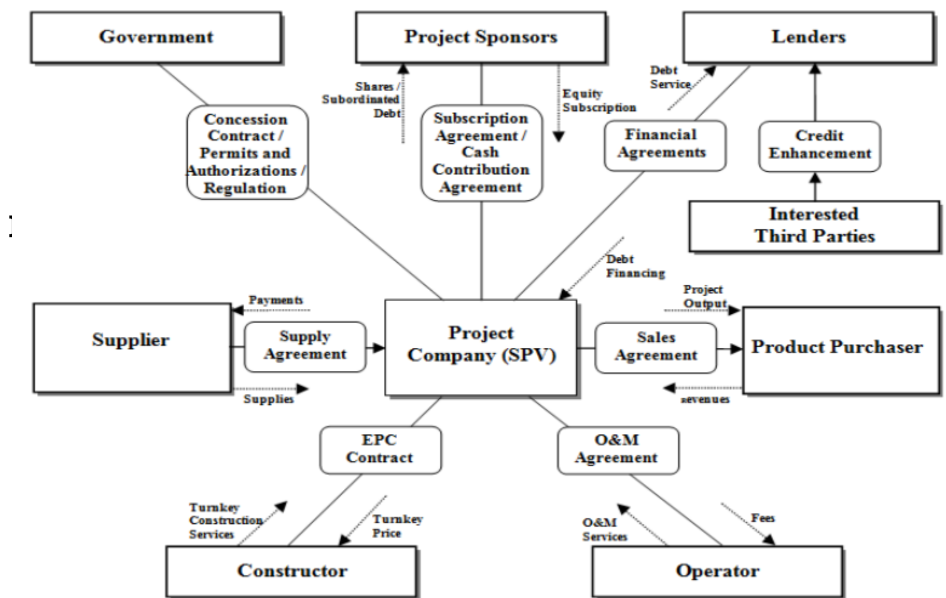
[20] Alexander Loke, 'Risk Management and Credit Support in Project Finance', Singapore Journal of International and Comparative Law 2 (1998), 37–75, at 37.

or bank institutions that provide funds for the project to the [project company or] Single Purpose Vehicle ("SPV"). Sponsors [or grantors the shareholders or companies that [organized the project company]. They provide some funding and guarantees for the project.[21]

Third, project risks are allocated to those parties that are best able to manage them. Fourth, the cash flow generated by the project must be sufficient to cover operating cash flows, and service the debt in terms of interest and debt repayment. This involves borrowing money to finance a project, in the hope that the project will make enough profit to cover the loan sum, and all accrued interests without diluting the existing equities.

Finally, collateral is given by sponsors to financiers as security for cash inflows and assets tied up in managing the project. Young[22] referred to it as an Off-balance-sheet debt treatment, in that the Sponsor, creates a legally independent entity to own the project assets; as such the project financing is off the Sponsor's balance sheet.

Fig. 1



Project financed transactions usually involve the following key aspects:

[21] "*Risks Associated With Investing in Project Financing Structures*, available at: <https://www.dentons.com> [Accessed 5 March 2022]

[22] Ibid.

i. The SPV, a newly incorporated company for developing the project; [Project Company]: an entity…, created with the single purpose of [implementing] a project.

ii. The sponsor or shareholder, the parent company of the SPV that is, inter alia, responsible for infusing equity into the proposed project, and providing the required sponsor support to the lenders funding the project in most developing nations.

iii. The lenders, which extend long-term financial assistance to the SPV for the implementation of the project in an agreed debt-to-equity ratio, and enter into the financing and security documents; A variety of commercial banks, export credit agencies, insurance companies, pension funds, and other finance entities, may participate in a project financing through public or private debt placements. Multilateral and development finance institutions, some of which are global in reach and others regional, may also act as lenders. The identity of the lenders to a particular project will depend on a variety of factors, which will include, the extent of any existing commercial relations between a particular sponsor and bank, the political and/or economic/social developmental importance of the relevant project, its location, and its commercial risks.

iv. The operations and management (O&M) contractor, which is appointed by the SPV for the operation and maintenance of the project after commissioning.

v. The off taker, which procures the project product and enters into an offtake agreement, to record the terms of the offtake (critical as this is the entity responsible for payment of revenues to the SPV).

vi. The landowner, from whom the land for the project is procured by a sale or lease deed executed by the SPV – the availability of encumbrance-free land being critical for large infrastructure projects.

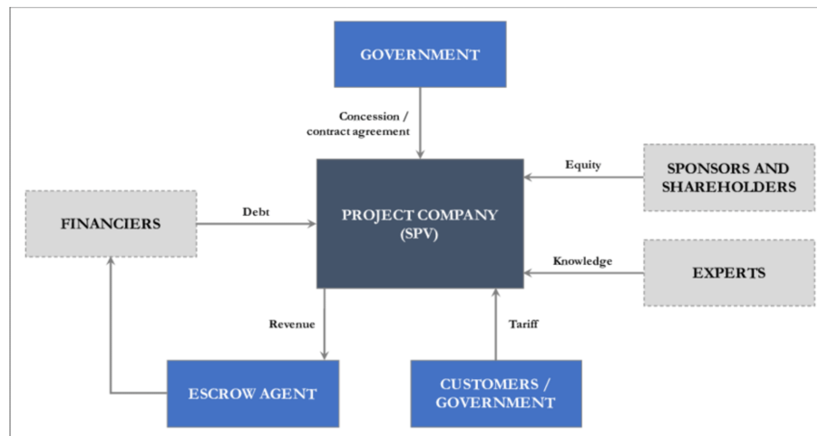
vii. In power projects, the transmission entity, because contractual arrangements with the transmission licensee are required to get a right to extract power from the project.

3.0 APPLICATION OF PF IN PRIVATE INFRASTRUCTURES

The thesis of this paper is that project finance can be successfully applied to private projects.[23] It is conceded that PF is mostly applied to government projects. But the structure of a Public Private Partnership model can equally be suited to private investments.

Like a PPP, where there are debt holders, an SPV and the authority. In Private Project finance, this structure can be established through creating a project company, S.P.V, and two, the debt holders which are in most cases the financial institutions such as banks can be catered for. Thus, when it comes to the authority which, in government projects, is the project beneficiary, it is submitted that a private sponsor such a company, individual or group of individuals can successfully be appointed as the project beneficiary.

23 Infrastructure may be owned and managed by either governments or private companies and, in the case of government ownership, may be developed and operated in the private sector or through public-private partnerships. Infrastructure financing can take many forms, including direct lending, commercial bank loans, project bonds issued via public capital markets or private placements, direct equity investment and funds raised from managed infrastructure funds. *See* "UNLOCKING INVESTMENT IN INFRASTRUCTURE", Is current accounting and reporting a barrier? (B20 Panel of six international accounting networks June 2014 <https://www.pwc.com> [Accessed 5 March 2022]



Typical Financing Structure of a Public-Private Partnership Project (United Nations ESCAP, 2011).[24]

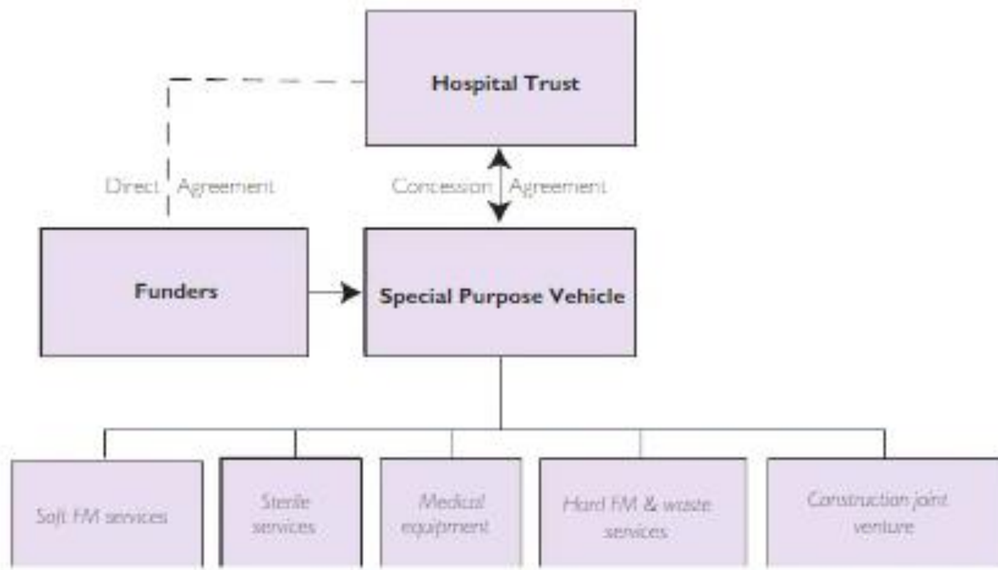
The diagram on Public-Private Partnership project (United Nations ESCAP, 2011 illustrates a model of project finance for government projects. This same model can be extended to private infrastructure, albeit without the intricacies of Public Private Partnership. To this end, the Government entity in the diagram above can be substituted for a private sponsor.

A case in point is in the case of *Royal Bank of Scotland PLC v. Chandra***.**[25] This case involved a bank seeking to enforce guarantees made by a business couple, in relation to financing their company's hotel construction project. According to the defendants, the bank, by its step-in activities, made under the agreement with the contractor, had released them from obligations to it. The court held that the couple's company was liable to the bank in respect of the liabilities the bank incurred and paid to the contractor following step-in.

This diagram below is a model structure of project fiancé for a private sponsor (which is the Hospital Trust).

[24] Typical Financing Structure of a Public-Private Partnership Project (United Nations ESCAP, 2011) <https://www.researchgate.net/figure/> [Accessed 5 March 2022]

[25] *Royal Bank of Scotland PLC v Chandra*, [2010] EWHC (Ch.) 105, [31], [2010] 1 Lloyd's Rep 677 (Eng.).



Sourced from James BarlowMartina Köberle-Gaiser.[26]

This model of PFI shows the key players including an SPV, Project sponsor (e.g. Hospital Trust and the funders, which include debt holders like banks, shareholders among others.

4.0 Legal Framework Enabling PF in Uganda

Although project agreements are mostly governed by the *Contracts Act 2010*. There are other laws which enable the regime of project finance in Uganda. The *Companies Act no. 1 of 2012* facilitates the formation of a project company. The *Partnerships Act 2010* enables the formation of partnerships, which can be the Special Purpose Vehicle to hold the project assets.

The *Companies Act no. 1 of 2012* facilitates the formation of a project company. The *Partnerships Act 2010* enables the formation of partnerships, which can be the Special Purpose Vehicle (SPV). The Contracts Act 2010 and the Sale of Goods and Supply of Services Act 2018 control the counterparties in project finance.

[26] James BarlowMartina Köberle-Gaiser, "*Delivering Innovation in Hospital Construction: Contracts and Collaboration in the UK' s Private Finance Initiative Hospitals Program,*" W3456 <https://www.academia.edu/> [Accessed 5 March 2022]

The Project assets can be secured as collateral in accordance with the secured transactions laws. These include the *Mortgage Act no. 8 of 2009*, the Security in *Moveable Properties Act 2019* to mention but a few.

5.0 LEGAL AND REGULATORY RISKS INVOLVED

Gatti (2008) identifies risks related to the pre-completion phase – activity planning risk, technological risk, and construction risk or completion risk; risks related to the post-completion phase – supply risk, operating risk, and demand risk; and risks related to both phases – interest rate risk, exchange risk, inflation risk, environmental risk, regulatory risk, political risk, country risk, legal risk, and credit risk or counterparty risk.

Private Finance can be seen as a system for distributing risk among the parties involved in a venture. Madykov noted that PF is an aggregation of legal contracts that allocate resources and risks.[27] These risks are allocated contractually to the parties best able to manage them. A risk is the probability of occurrence of a defined hazard,[28] and the magnitude of the consequences. Once these risks have been identified, it is through the various contractual arrangements between the parties, and insurance, that these risks are, for the most part, apportioned and assumed.

5.1 Legal risks

These are concerned with enforceability of contracts, structural risks, and jurisdiction other than regulatory aspects of the project.

5.1.1 Enforceability.

Not all contracts are enforceable in accordance with their terms. There may be mandatory provisions of law that override the terms of the contract. Many countries have civil or similar codes whose provisions will apply to a contract

27 "*Step-in Right as a Lender Protection Mechanism in Project Financed Transactions*" <https://via.library.depaul.edu/ > [Accessed 2 March 2022]

28 A Hazard is a particular event, which has the potential if it occurs of an adverse effect. Risk Management is the identification, measurement and economic control of risks.

notwithstanding its terms.[29] The interface issues or risk allocation must be addressed in each of the project contracts so that the risk is allocated to the project stakeholder that is best equipped to manage the risk and to ensure that the entire risk does not sit with the SPV.

In some cases, mandatory provisions of law will be applied by the courts even if not applicable under the express law stated to govern the contract. Thus, parties need to assess not only the terms of the relevant agreements, but also their consistency with applicable law. Loss of project contracts to non-enforceability and illegality can be avoided. Project agreements must be protected from risk of illegality and non-enforceability by law.

In this respect, it should be noted that a typical contractual framework in project financing includes:

i) Construction contracts and engineering, procurement, and construction (EPC) closed on a turnkey basis
ii) Purchasing agreements to guarantee raw materials to the SPV at predefined quantities, quality, and prices
iii) Selling agreements enable the SPV to sell part or all of its output to a third party that commits to buy unconditionally at predefined prices and for a given period of time
iv) Operation and maintenance agreements compliant with predefined service-level agreements and others such as facility or loan agreement, trust and retention account agreement, security trustee agreement, intercreditor agreement, facility agent agreement or lenders' agent agreement.

Albeit proper drafting, any void agreement risks affecting the viability of the project. Corielli(2010) argues that one of the key characteristics of PF transactions is the existence of a network of nonfinancial contracts (NFCs),

29 "Basic Principles of Contract Drafting," <https://www.ulapland.fi/loader.> [Accessed 4 April 2022]

organized by the SPV with third parties, often involving the sponsoring firms as well, i.e., a PF transaction can be viewed as a nexus of contracts between the players involved in such a deal.

a. Force Majeure

The obligation to repay the loans will continue in the event of force majeure or change in law. "Force majeure" (which literally translates as, "superior force") is not a rule of law but a label used to a describe a contractual term that excuses a party from performing his contractual obligations if a specified event occurs that is outside his control.[30]

It is however important to note that a force majeure clause cannot be implied into an agreement, and parties can only rely on this concept if it is expressly covered in the agreement. In the case of *Cafe Technical Services Ltd Vs J. W. Opolot Construction (U) Ltd,*[31] it was explained that "the fact that a contract has become uneconomic or commercially impractical will likely not be considered a force majeure event, unless expressly provided for."

b. Change in law

A mere change in law can affect the enforceability of project agreement. This event is also called supervening illegality. In the case of *Ralli Brothers v. Compania Naviera de Sota y Aznar.* In this case a contract, the proper law of which was English, provided that freight at the rate of £50 a ton should be paid in Barcelona for a cargo of jute to be shipped to that port. After the date of the contract, but before the arrival of the cargo, a Spanish decree fixed the maximum freight on jute at a lower rate than the contract rate and made it illegal to pay more.

It was held that only the Spanish rate was payable and not the higher contract rate. In *Ham Enterprises & Ors versus DTB Bank (U) Ltd & Anor*, where the loan agreement, not illegal or prohibited at the time of its formation in Kenya,

30 "*Force Majeure Clauses - Checklist and Sample Wording*" <https://ppp.worldbank.org/> [Accessed 5 March 2022]

31 HCCS 0007 of 2013

became unenforceable upon its default in Uganda and the manner of enforcing the security involved a nonparty DTB (U) Ltd to enforce a security. It is clear that the loan agreement not illegal not prohibited at the time of its formation in Kenya became unenforceable upon its default in Uganda and the manner of enforcing the security involved a nonparty DTB (U) Ltd to enforce a security. Although this case was controversial as to the application of illegality, it highlights potential flaws in foreign lending by project lenders, the fate of which can be circumvented even in changes in law.

Given that project agreements are granted through syndicated loan, it becomes relevant for project finance lawyers to provide for choice of law in case of certain changes in law.

c. Forum.

The choice of the forum for the determination of disputes arising from the transaction (including the extent to which judgments or arbitral awards that emanate from that forum need to be considered.[32] The selection of a forum for any disputes heard in connection with the project has important implications such as:

i. Will the forum be neutral in its decision-making?
ii. What law will the chosen forum apply and will the outcome differ as a result?
iii. Which evidential or procedural rules will apply in the forum?
iv. Will judgments or awards be enforced in the home jurisdiction of the borrower or the other project parties?

In many jurisdictions, the courts can compel parties to disclose facts or documents, and may be able to order interim relief, such as injunctions that prevent a party from moving assets out of the jurisdiction. In *Ham Enterprises*

[32] In international project finance transactions, the parties must determine the law that should govern their transactions (to the extent they have a choice) and whether any disputes that arise under the documents will be resolved through arbitration or judicial means. "*Identifying and Managing Project Finance Risks*", available at: https://www.milbank.com, [Accessed 4 February 2022]

& 2 Others v Diamond Trust Bank & Another [33] although the issue was on enforceability of a foreign contract by a foreign lender. The issue of jurisdiction was a missed opportunity. Instead the court skirted around the issue relying on the illegality of a foreign lender from enforcing a contract in Uganda.

This was because DTB(K) ltd had no licence to operate as a financial institution in Uganda. However, jurisdiction would have been avoided if the financing agreements specifically provided for Uganda as forum for dispute.

d. Secured packages

Project financings are in essence complex secured lending transactions. The willingness of lenders to extend long-term credit to a project may depend on, the degree of comfort they take, in the viability of the underlying security 'package'.

In Uganda, secured transactions are primarily governed by the *Mortgage Act,*[34] *SIMPO,*[35] *Companies Act,*[36] to mention but a few. These securities include mortgages, charges, pledges and liens. Charges and mortgages are generally the most important categories of security interest in a project finance context. Mortgages and charges of land are subject to special rules. Mortgages and other types of quasi-security include negative pledges, finance leasing, set-off and retention of title[37].

The project lender has to ensure compliance with the Mortgage laws, for instance in *Mubende Parents School Ltd v. Uganda Development Bank Ltd & 2*

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33 *Ham Enterprises Ltd. & 2 Others v Diamond Trust Bank & Another* (Miscellaneous Application 654 of 2020) [2020] UGCommC 32

34 No. 8 of 2008

35 Security in Moveable Property Act 2020

36 No. 1 of 2012

37 Equitable mortgages were removed from the Registration of Titles Act. Previously section 129 (1) of the RTA. See also the case of *Barclays Bank of Uganda Ltd v John Hilton of the Republic of Uganda Northcote and Another [1976] HCB 34,* which stated that an equitable mortgage can be created, inter alia, by; mere deposit of title deeds with a clear intention that the deeds should be taken or retained as security for the loan; an agreement to create a legal mortgage; or mere equitable charge of the mortgagor's property.

Others,[38] civil suit 662 of 2015, the court held that the mortgagee has to comply with section 19 of the Mortgage Act even in the debt recovery process.

It should be noted that an S.P.V must comply with the company laws in issuance of its securities. For instance, it is an offence for a person to issue a form of application for a company's shares or debentures without a prospectus and without having been so exempted under section 90 (g) of the Companies Act No. 1 of 2012.

5.2 Regulatory risks

A regulatory risk is generally defined as the risk of having the 'licence to operate' withdrawn by a regulator, or having conditions applied (retrospectively or prospectively) that adversely impact the economic value of an enterprise.[39]

a. Corporate governance.

If a project company is organized under local law, which is frequently a requirement of host governments, the investors and lenders will need to assess the governance flexibility afforded to them by that law. An example where corporate governance was flouted was in the case of *Infrastructure Projects Ltd v Meja Projects Ltd.*[40] For the record, the court noted that section 200 of the old Companies Act Cap 110,[41] which was in force at the time the contract in issue was made required a director to disclose interest in a contract that his company was entering at a material time.

It further noted that this was to guard against the dangers of conflict of interest and to ensure corporate responsibility so that individuals do not abuse the corporate veil. In this case the plaintiff's director did not disclose in the suit contract that he had shares in the company his other company was contracting with and therefore did not comply with this requirement of the

38 High Court Civil Suit 662 of 2015

39 "*Regulatory Risk Management*" available at <https://www.pwc.com> [Accessed 5 March 2022]

40 C.S. No 2351 of 2016

41 This Act was replaced by the Companies Act No. 1 of 2012

law and this rendered document No.3 i.e. the (consultancy agreement) unenforceable.

Another corporate governance issue of relevance to investors is to ensure that the ability of the company to distribute profits to shareholders is not unduly constrained by corporate law and local accounting practices.[42]

b. Industrial regulation breaches.

The Project lenders will need to be satisfied that there are no regulatory constraints imposed on them by any of the authorities that regulate their activities or pursuant to laws applicable to them.

Many projects operate in regulated industries. The vast majority of countries, whatever their level of economic and political development, impose regulatory oversight on their public utilities (power, water, and telecommunications), transportation and other infrastructure sectors. Regulation can encompass a licensing regime, under which permission to operate is granted to specified companies or classes of companies.[43]

The construction and operation of a project generally requires the project company to obtain a broad range of permits and consents, in relation to matters ranging from environmental and social impact to land use, health and safety and industrial regulation. The permits that may be required on a given project include occupation permits, building permits, Environmental Impact Assessment and electricity permits, mining licences, operating licences for schools and private hospitals.

The project lender will need to ensure that the project activities do not violate the any permit conditions that must be complied with.[44]

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[42] "*Approaching Legal Issues in a Project Finance Transaction*," https://books-library.net Accessed on 5th March 2022

[43] P. Fletcher and J. Worenklein, 'Regulatory Considerations in the Project Financing of an Independent Power Production Facility' 8(4) Journal of Energy & Natural Resources Law (1990).

[44] Regulation can encompass a licensing regime; under which permission to operate is granted to specified companies or classes of companies and may (and often does) extend further to dictate the manner in which a project company is to operate and, in many cases, the prices it may charge for its services or output.

c. Lack of Permits and licensing.

The construction and operation of a project generally requires the project company to secure a broad range of permits and consents. The subject matter of these range from environmental and social considerations, to land use, to health and safety and industrial regulation.

***d.* Taxation and fiscal compliance**.

Virtually all projects are subject to some form of taxation, and the tax regime will generally have a significant impact on the project's economics. Most sponsors assess their return on investment on an after-tax basis, and thus consider clarity and certainty of the tax regime to be a key consideration.

***e.* Corporate taxes.**

The project company is likely to be subject to corporate taxes, often calculated on the basis of the profits arising to it. The project lender needs to take into account the tax liability of the income generated by the project assets.

f. Customs and immigration law.

Whenever goods or individuals cross a border, they become subject to the laws of both the country they are leaving and the country they are entering. For projects, the concern is generally focused on the ability of the project to import into the host state key goods and equipment and to employ qualified expatriate managers, engineers, and labour.

g. Labour restrictions.

The issue of compliance with labour laws cannot be overemphasized. May permit some limited employment of expatriates, but may also require the training and employment of local nationals. It is critical for the project company and its independent contractors to comply with labour laws such as the Labour Unions Act 2006, the Occupational Safety and Health Act and the Worker's Compensation Act. . It is important to remind ourselves that some

project lenders can withdraw financing to a project over labour related infringements[45].

h. Environmental and social risks.

The construction and operation of a project invariably have environmental and social impacts on the locality of the project. Lenders will generally require, at a minimum, the project company to undertake to comply with all environmental and social laws and regulations binding on it.

In the decision of *Godfrey Nyakana vs National Environment Management Authority (NEMA) and Others;*[46] it was held that under the National Environment Act, NEMA is empowered to act to preserve wetlands by, among other measures, issuing restoration orders to offenders directing them to restore the environmental conditions found before their encroachment.

In this case, the appellant had been issued a lease, obtained planning permission and had begun building a residence in a wetland. In 2004, NEMA issued a restoration order to the Appellant directing him to demolish his house within 21 days.

It is submitted that project lenders should be concerned with environmental regulatory risks attached with the project land and activities.

6.0 MITIGATING THE LEGAL AND REGULATORY CHALLENGES BY PROJECT LENDERS

Contractual risk allocation or risk transfer is a form of risk management employed in the construction industry. It involves the allocation or distribution of the risks inherent in a construction project between or among contracting parties. In contractual risk allocation, the contract is the vehicle for risk allocation. Whether the contract is for construction, civil engineering, design, design-build, or some other aspect of Road or infrastructure

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[45] "*Bank pulled plug on $265m transport scheme after allegations that construction workers targeted schoolgirls and reports of poor treatment of workers",* available at https://www.theguardian.com, Accessed on 14th December 2021

[46] *Godfrey Nyakana vs National Environment Management Authority (NEMA) and Others* Constitutional Appeal No. 5 of 2011)

construction or management, it defines the roles and responsibilities for risks. Risk allocation in any contract affects cost, time, quality, and the potential for disputes, delays, and claims, including the risk of destruction and/or deterioration of the works.

To obtain project financing, a borrower needs to ensure that the project documents that it executes for a project are bankable in addition to risks being capable of mitigation. Some of the project documents that are usually required as a condition precedent to funding by lenders are the EPC contract, concession agreements (in road projects, ports, railways, to mention but a few.) and PPA (for power projects).

To ensure enforceability of project agreements, the project lawyer needs to identify the events of default and determine the liquidated damages in such circumstances. In case of breach of the contract, the liabilities of the project company can be adequately allocated and catered for by other parties to the project.

In *Dei Minerals International Ltd & Others v Videocon Industries Ltd & 8 Others*[47]**,** the case involved breach of contract, where the defendants failed to return the mining licenses to the plaintiff company to execute a joint venture. The court noted that, in the instant case, the defendants knew that the licences had a time span and required renewal by the holders of the licences.

They neither applied for renewal nor transferred the mining licences back to the plaintiffs to enable them apply for renewal. The court found that the resultant loss was foreseeable by the defendants and is found liable for losses incurred by the plaintiffs.

Securitization. There must be adequate performance security (to be assigned to the lenders) obtained from the EPC contractor, to ensure performance of the EPC contract or to mitigate construction risk.

47 *Dei Minerals International Ltd & Others v Videocon Industries Ltd & 8 Others* (HCT - 00 - CC CS - 155 - 2014) (2014) UGCOMMC 65 (30 January 2015);

Step-in right for the project lenders. There must be a collateral assignment of the main project contracts such as the EPC contract, PPA, the O&M agreement, to ensure that the lenders are entitled to step into the shoes of the SPV on occurrence of an event of default.

Right to possession of the site and Land due diligence. Also, the Project borrower needs to carry out Land due diligence procedures to ascertain that the SPV has the legal right to the land, rights of way and development approvals where the project is to be developed. Guangzhou Dong Song Energy Group Limited, a Chinese firm producing phosphate fertilizers in Tororo, Eastern Uganda, is locked in a court battle over alleged fraudulent acquisition and ownership of a multi-million dollar mineral deposit[48].

If the SPV is a foreign company, it will not have capacity to hold land under certain land tenures. The title documents in favour of the SPV need to be verified. Another important aspect that needs to be verified is if the land title documents and related policies impose any restrictions or approval requirements for the creation of security in favour of the lenders over the project land. For instance, Uganda's land laws prohibit land ownership in Mailo, customary and freehold land by foreigners except on lease basis.

Let's consider the decision in *Crane Bank (in receivership) v. Meera Investments & Anor*[49], where the Court of law declined to order a retransfer of Mailo land titles from Meera Investments Ltd to Crane Bank which was found to be a foreign entity. Even though there were allegations of undervaluation of the sales to Meera Investments Ltd, the Court of Appeal overlooked the pleadings and focused on the non-justiciability of the illegality in land ownership. That is, that Uganda's land laws expressly prohibit land ownership by foreigners in Mailo interest.

48 "*Fertilizer Company, Directors In Court Over Mineral Deposits*," available at: https://www.busiweek.com accessed on 5th March 2022

49 *Crane Bank (in receivership) v. Meera Investments & Anor* (Civil Appeal-2019/252) [2020] UGCA 2050 (23 June 2020) Available at https://ulii.org/ug/judgment (accessed 15th Jan 2022)

In *Biyinzika Enterprises Ltd & Others v Biyinzika Farmers Ltd & Another,*[50] the Court of Appeal held that where the Articles of Association of a company do not restrict transfer of shares to non-Ugandan citizens, the company is deemed a foreign company and cannot hold mailo land irrespective of the fact that Ugandan citizens have majority controlling interest.

Ensure availability of consents and permits. Usually, lenders would require that all the required permits for a project to be developed and constructed are available prior to the first drawdown. Accordingly, at this stage the lenders check if all the required government permits are available with the borrower. Some of the usual permits required by a project are as follows: environment-related clearances, land-related approvals; permission from the relevant government regulatory authority for power required during construction; and labour approvals[51].

For example, in the Indian context, in the recent case of *Common Cause v. Union of India*, the Supreme Court of India imposed obligations on mine developers to pay compensation for carrying out mining operations without valid statutory clearances, and ordered the suspension of mining operations till the payment of compensation and the procurement of all applicable clearances.

Ensure corporate compliance of the SPV. In Project Finance, the submission of corporate authorisations and certifications is broad. It typically includes relevant resolutions from the board of the borrower authorising borrowing and the related security creation, resolutions from the board of the parent providing security or executing a sponsor support undertaking and shareholder resolutions in connection with the borrowing of the SPV by its shareholders and shareholders of its parent. The latter depends upon transaction requirements and as may be required under the provisions of

50 Civil Appeal No. 18/2012

51 This exercise is imperative not only to prevent potential roadblocks to the timely implementation of the project but also to prevent adverse financial implications through penalties or fines imposed by government authorities in the absence of the required consents or approvals.

company law in the relevant jurisdiction. In addition, it is a check to ensure that the lenders' rights are protected with regard to the shareholders.

Another measure is to require submission of all project documents, project consents, approval, land documents, insurance contracts and any other regulatory requirements for the project being financed. The execution of financing and security documents, submission of financial models, to mention but a few should also be done, as well as submission of compliance reports or certificates from transactional advisers. These include engineers, lawyers, financial advisers and insurance advisers that are usually retained by lenders to identify potential risks and ways of mitigation before disbursement;

Noncompliance with procurement laws. Some infrastructure projects had major problems in the bidding phase.[52] Most project financings are at risk of cancellation for breach of procurement laws and procedures.

Specific Priority of documents and incorporation of conditions. Many contractual disputes within the construction industry arise because of differing opinions over what the parties believe the contract terms mean, as opposed to what is actually written down. In *Fence Investments Inc v Jerram Falkus Construction Ltd*[53], the court had to consider the construction of a contract. In particular, it looked at the effect of a clause concerning the priority of documents, vis-à-vis an insertion in the employer's requirements that purported to change the payment mechanisms in the contract, in order to determine which of two conflicting provisions relating to the payment mechanism was to prevail.

Court thought that the conflict in the provisions was fundamental and, in its judgment, would lead to an unworkable set of contract provisions, it was also

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52 "*A Review of Canceled Private Projects*" available at: https://.worldbank.org accessed 5th March 2022

53 Fenice Investments Inc v Jerram Falkus Construction Limited and Others [2009] EWHC 3272 (TCC)

fundamental because it affected the starting point, and thus the end point, of the payment mechanism.

Commentators on the *Fenice* case have in chorus stated that the case is good example of the need for employers (in this case project lenders) to ensure that any contract amendments are incorporated correctly and are not simply included with other contract documents, such as the Employer's Requirements or Contract Preliminaries, so that the contractual arrangements are clear.[54]

Incorporate restrictive and prohibitive usual covenants on the SPV. The facility agreement provides for affirmative covenants, negative covenants and financial covenants each of which is discussed in brief below. These covenants are usually well-negotiated between the borrower and the lenders.

Affirmative covenants primarily record the continuing obligations of the SPV. Some of the usual affirmative covenants are compliance with applicable laws and clearances, the SPV's insurance and credit-rating obligations, the payment of taxes and other statutory dues and the lenders' right to inspect. They also entail the preservation of security, the constitution of the project management committee and audit subcommittee as required by the lenders, and the agreement to appoint an observer or lenders' nominee director on the board of the SPV.

On the other hand, negative covenants prohibit the SPV from doing certain acts that are considered prejudicial to the lenders' interests, such as transferring assets, granting or issuing security, and incurring indebtedness (other than in favour of project lenders). Some of the typical negative covenants that would require the lenders' prior written consent include a change in management or board composition.

7.0 CONCLUSION

[54] Construction of Contracts: Priority of Documents, by Christopher Hill, Steve Abraham and Donald Warnock of Norton Rose, UK, August 2010. <https://www.mondaq.comAnd>Starr, ibid.

The principal role of project finance lawyers, once they have identified and analysed the various risks applicable to the project, is to mitigate those risks so far as practical by documentation in the context of the negotiating leverage of the parties.[55] Thus, the goal of this paper was to expose some of the legal issues and risks attaching to projects by private sponsors in addition to justifying the extension of project financed transactions to private sponsors.

55 "*International Project Finance*" available at https://www.lexology.com/library/detail.aspx?g=6be83df7-de16-48ef-a12d-fe48604b7e58 accessed 2nd March 2022

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