

The Department of Law
School of Business and Law at Göteborg, University
Spring 2006

PROJECT FINANCE AND THE EFFICIENCY OF DIRECT
AGREEMENTS UNDER SWEDISH LAW
– THE TREATMENT OF THE DEBTOR’S CONTRACTS IN
BANKRUPTCY

Exam thesis 20 p

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1. Introduction

1.1 Acknowledgements

My grateful thanks for this thesis are due to Jan Kansmark at Mannheimer Swartling law firm who has shared his comprehensive experiences from project finance with me and been very supportive and encouraging throughout this journey and to Lisa Almén at EIB who patiently has replied to my numerous questions and with whom I have had supportive and inspiring discussions. I also want to thank Denis Petkovic (at Chadbourn and Park law firm), Philip Wood and Anthony Humphrey (at Allan Overy law firm) who provided me with accommodating consultation and materials. Finally, a special thanks to my tutor Rolf Dotevall, who jumped in at a late stage in this process, and made an efficient and encouraging work.

1.2 Opening

Public private partnership (PPP) is an alternative method for the financing of public infrastructure, based on the concept of financing public undertakings by private funds. The technique can be used in a number of different sectors such as transportation, energy, waste management, housing, education and healthcare. However, the focus for this essay is made to large-scale capital-intensive infrastructure projects such as, *inter alia*, motorways, railroads, bridges, water supply and energy facilities. PPP is commonly used all over Europe, particularly in England, and have recently grown exceedingly in the Nordic countries. Despite this European trend, the Swedish government has so far been hostile against making use of the PPP. However, given the positive outcome from the development that has taken place in the Nordic countries, Sweden is likely to follow the track.

There are various forms of private public partnerships¹, however, the basic concept is that a private company, solely established for the purpose of carrying out the project in question,² takes the primary responsibility for the financing, designing, building and operating of a project facility, which is then transferred to the public sector.³ Using such a single purpose

¹ There are various forms and definitions of PPP depending on the magnitude of the private sector involvement. This essay predominantly deliberates BOT, a form of partnership considered to provide great advantages for the public sector and has therefore been supported by the United Nations and the European Union. For further guidance on different forms of PPP and categorisation see for instance Uncitral, United Nations, Legislative guide on privately financed infrastructure projects, New York, 2001, p. 5, § 19

² Such a project company is often referred to as a single purpose vehicle (SPV).

³ European Investment Bank, The EIB's role in public-private partnerships, Luxembourg, 2004, p. 15

vehicle (SPV) reduces the risks for the project sponsors thus making it possible for them to attain a “non-recourse financing”. This means that the lenders have no recourse against the project sponsors and therefore only may take recourse to the assets held by the project company for the repayment of their loans and for interest payments on such loans.⁴

However, the value of the asset of the project company, at least at the beginning of the construction phase, is significantly limited and uncertain. There is often no established market for project assets such as a power plant or a motorway and the facilities are in general owned by the public sector, rather than the project company.⁵ The non-recourse financing technique in addition to the fact that there is no real asset to take security in thus exposes the creditors to considerable risk. The lenders are forced to almost solely rely on the future revenues of the project company.⁶ Both the creditors and the equity holders therefore focus their attention on the prospective future cash flow of the project company.⁷ The most important objective for the creditors as well as for the equity holders is thus to keep the project running. The future revenues are generally provided by the public sector party, once the project is finalized. Hence, the key threat is a public sector party cancellation of the contract.

In order to make these projects “bankable” the parties involved are forced to create innovative contractual solutions taking these foreseeable conditions into consideration. Apart from the traditional form of security, various forms of “quasi security” are often used. One of the most important features in this regard is direct agreements. Direct agreements are entered into between the project company, the banks financing a project and the parties to the project’s key underlying commercial contracts. 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.⁸ The objective of a direct agreement is basically to enable the banks to “step into the shoes of the project company” if it defaults in its loan obligations. The agreements provide a right for the creditors to assume the project company’s rights and obligations under the contract for a specified period of time or allow the transfer of the contract to a separate company established by the banks for this purpose. If such an assumption is made, then the project contractors can

⁴ Vinter, *Project Finance, a legal guide*, 1998, p. 111.

⁵ Wood, *Project Finance*, 1995, p. 24.

⁶ Merna & Cyrus, *Financing and managing of infrastructure projects*, 1998 p. 110.

⁷ Merna & Cyrus, *Financing and managing of infrastructure projects*, p. 110.

⁸ Wood, *Project Finance*, p. 32.

not terminate the defaulted contracts prematurely, their cancellation rights are to say “frozen”. Hence, direct agreements draw third parties into a projects finance agreement in that compulsory consent to accomplish an eventual assignment is obtained prior to such transfer is being considered. In doing so, the lenders can hinder third parties from exercising their contractual rights.

However, direct agreements are met in accordance with English law, which is generally considered more ‘creditor friendly’ than the Germanic law tradition. Albeit the parties involved have agreed upon this solution, implications in the Swedish jurisdiction may render these agreements ineffective. The key threat to the efficiency of using direct agreements in Sweden is the potential bankruptcy of the project company. The bankruptcy itself does not necessarily create significant complications for the lenders, however the expected right of the bankruptcy’s estate to enter into the debtor’s contracts exposes the lender to higher risk.

1.3 Purpose

The purpose of this essay is to examine the efficiency of direct agreements used in private public partnerships and project financing in general, relating to large-scale infrastructure projects, in the light of Swedish law, particularly with regard to the project company’s bankruptcy and the principal rule of the estate’s right to enter into the debtor’s contracts.

The two basic questions are, firstly whether the bankrupt estate is entitled to enter into the project company’s contracts, (or from a contractual perspective, whether the solvent party is entitled to cancel its contractual obligations) and secondly whether the right of the estate to accede to the project company’s contract is mandatory and hence an agreement opposing such right is void against the estate. The essay seeks to discuss these basic questions *de lege lata* as well as *de lege ferenda* in Sweden and to compare the legal situation in the Nordic countries and in England.

Furthermore, the purpose of this essay is to suggest solutions of the problems evinced, principally to devise a law reform.

1.4 Delimitation and background to the problem selected

Since the objective of this essay is to examine the quandary of the bankrupt’s estate to enter into the debtor’s agreement, with regard to the particular nature of project finance, there is no

room for the various techniques and models to be presented in detail. The essay does not provide a comprehensive description of project finance, private public partnership or direct agreements. Apparently, essential components necessary for a proper understanding of the discussion here presented may be wanting. In order to provide a comprehensive conception, some elements of the particular nature of project finance are especially underlined and consequently, some repetition will transpire.

The essay predominantly deliberates implications from the lender's point of view. However the interest of the public party is of fundamental importance and hence presented as well.

The set of question here examined have been selected against the background of a general analyse of the potential implications ensuing from the application of Swedish law on direct agreements, within different legal areas. However, a brief delimitation was firstly conducted and hence legal areas such as European community law and competitive law, communal-, environmental law and other particular individual Acts such as the Road Act etc, have not been deliberated at all. The legal areas subjected to review can be summarised to; contractual, property- (sakrättsligt) and company law perspectives. The analyse concludes that the application of the Swedish rules on the debtor's estate right to accede to the project company's contracts, are likely to cause the most severe implications for the efficiency of the lender's rights approved in direct agreements. However, it is here suggested for further examination to be conducted within these legal areas. Besides the two matters of concerns; the various means for the lender's to obtain control over the project in accordance with the Swedish law, and the effects of taking (and enforcing) security over the concession contract, are here recommended to be subjected to further scrutiny as well.

1.5 Method

The method used in order to achieve the outlined purposes is predominantly carried out by comparative literature studies. Swedish and Nordic legal doctrine is compared with English litterateur and case law. Besides, descriptive literature of project finance and private public partnership has been studied. Helpful guidance has been provided from a number interviews and general discussions conducted in England and with practitioners at Swedish law firms and companies.

The set of questions are predominantly examined from a functional perspective and the essay chiefly deliberates a contractual, bankruptcy and property law perspective. The essay have an analytic approach throughout the whole essay and seek to apply and examine *de lege lata* simultaneously, hence, the legal situation is presented in conjunction with the general discussion.

1.5.1 Disposition

The opening above has given an introductory presentation of private public partnerships and project finance and the particular risks induced in such financing techniques. The introduction results in the set of question that is to be examined, the efficiency of one of the particular security arrangements used in these financing techniques, so called direct agreements, under Swedish law. The rules of the bankrupt estate's right to enter into the debtor's agreement is considered as the key threat to the efficiency of such agreements and hence the quandary of this thesis. Before this is examined further, the first chapter provides a brief descriptive presentation of direct agreements and the purpose of using such contractual arrangements.

The following chapter introduces and provide a background of the principal subject of the examination, hence bankruptcy and contracts. The theme examined is unregulated and the next chapter seeks to analyse and apply *de lege lata* with regard to the special nature of project finance and private public partnerships. Light is shed on the contemporary debate in progress all over Europe as well, having bearing on the development *de lege ferenda*. Next chapter accomplish a balancing of interest, taking *de lege lata* as well as *de lege ferenda* into account. This balancing of interest also has the function of predicate and arguing for *de lege ferenda* and hence comprises the basis for a law reform. The final chapter discuss the scope and legal technique for such law reform. The objective for a law proposal is to carve out exception from the right of the bankrupt estate to enter into the debtor's agreement with regard to the particular nature of project finance. The essay concludes with a proposal of such law provision.

2. Description and purpose of direct agreements

The common view of security is that lenders take security over an asset in order to sell it if their loan is in default and to apply the proceeds against amounts outstanding under the loan. This is the "aggressive" nature of security - lenders are given rights entitling them to take a

valuable asset away from their borrower and to dispose of it for their benefit. In order for this view to coincide with reality, the asset in question should be relatively freely marketable and have a fairly ascertainable value and the lenders should be free to exercise their rights without the need for third party consents.

As indicated in the introduction, these factors are rarely present in a project financing and it may thus be questioned why a project financier should bother with security. Indeed, security serves a "defensive" as well as an offensive purpose - if a creditor has security over an asset, he ranks ahead of the general unsecured creditors and the ability of the unsecured creditors to interfere in the relationship between the debtor and the secured creditor is thereby limited. Besides, security may (depending on the legal systems concerned) entitle lenders to use an asset as opposed to merely selling it.⁹

The idea behind the defensive purpose of security is that the unsecured creditors would have little to gain by pursuing potentially disruptive action against the debtor (such as seeking to have it wound up) and that, even if the unsecured creditors did take such action, the secured creditors would to a large extent be insulated from its effects. The other purpose identified above (the "management" purpose) is really to give the lenders the option of taking over a project (and, if necessary, completing it) themselves.¹⁰

As far as banks are concerned, a direct agreement can be said to perform both a defensive and an aggressive function. It performs a defensive function in that it protects the banks against a precipitous termination of a project contract by the other contracting party and it performs an aggressive function in that it allows the banks to seize control of the project company's rights under the project contract.¹¹

It should also be noted that the typical direct agreement will refer to a novation of the project contract in two different types of circumstances. Firstly, the project contract can be novated to a work-out vehicle, really as a holding measure. The second is that the project contract is to be novated to a trade buyer, someone who wishes to buy the project outright from the banks. Although use of the terms is by no means widespread, a person to whom the project contract

⁹ Vinter, Project Finance 1998, p 149-150, Wood, project finance p. 30 and Wood, Comparative Law of Securities and Guarantees, p. 5-6 and 178-196.

¹⁰ Vinter, Project Finance, 1998, p 149-150 and Wood, project finance p. 30.

¹¹ Wood, Project Finance, p 32.

is novated as a holding measure is sometimes referred to as an "additional obligor", while a person to whom the project contract is novated as part of a trade sale is sometimes referred to as a "substitute obligor".¹²

It should be stressed as well that the step in rights are merely a right, hence the financier's are not obliged to step in, besides the lender's are generally approved to at any time step out again. What they will be anxious to avoid is that they are forced to inherit all of the project company's obligations under the contract in question, including its long-term obligations in relation to abandonment costs. Of course, the contracting party may insist that this is the price for him agreeing to the banks having step-in rights. The usual riposte to this is that even a temporary step-in must be of benefit to the contracting party because, without it, he will only be an unsecured creditor for any amounts he is owed and will have lost the ability to earn future amounts under the contract. Conversely, if the banks step in, not only will they (or an entity controlled by them) pay any amounts due and owing to the contracting party under the contract, they (or such entity) will also be liable for amounts becoming due during the period of the step-in. Furthermore, if the banks did not step in, the project company would probably not have been able to meet those obligations (such as abandonment costs) in any event (because the assumption is that the banks will be stepping in when the project company is insolvent).¹³

An example of the essential clauses for a direct agreement relating to a commercial contract is here presented:¹⁴

- "(A) The Agent [Bank] may, at any time, notify the Contracting Party that the New Entity shall be and be deemed to be a party to the Relevant Contract in place of the Borrower.*

- (B) The Agent (or the New Entity) may at any time thereafter, by a further written notice to the Contracting Party, require the Contracting Party no longer to treat the New Entity as the party to the Relevant Contract and the New Entity shall be released from all future obligations under the Relevant Contract from the date specified in such notice (being no earlier than the date of such notice).*

¹² Vinter, Project Finance, unpublished version from the 9 December 2005, chapter 8.

¹³ Vinter, Project Finance, unpublished version from the 9 December 2005, chapter 8 section 7 (a)

¹⁴ The example is provided from Vinter, Project Finance, 2005, chapter 8 section 7 (a)

- (C) *The Contracting Party agrees that, if it has the right to terminate the Relevant Contract and is intending to exercise such right, it will give the Agent at least [90] days' notice of its intention.*
- (D) *During the period referred to in paragraph (C) above, the Contracting Party shall continue to comply with all its obligations under the Relevant Contract and shall not terminate the same. Once the New Entity has been substituted for the Borrower in accordance with the above, the Contracting Party shall afford the New Entity [a reasonable time] [[] days] in which to remedy any outstanding breach and shall allow the New Entity to transfer its rights under the Relevant Contract to any purchaser of the Project Assets."*

3. Introduction to bankruptcy and contracts

3.1 Introduction to the problem

Under Swedish law it is uncertain whether the estate's entitlement to demand performance of the debtor's agreements or, as it is usually called, the estate's right to accede to the debtor's agreements, should be given status as an imperative right under the bankruptcy law. If so, agreements concerning rights of dissolution, cancellation or assignment by the solvent party would effectively be of essentially none effect against the bankruptcy estate.

The debtor's right to accede to the debtor's contract will thus have serious implications with regard to project finance and PPP in several aspects. The starting point is that the debtor's, the project company's contracts comprises certain value for the debtor's estate and the quandary is thus whether it should be included in the rest of the debtor's estate. The contract that is to be examined here is the project contract that has been entered into between the project company and the client, the public party. As regards the public party, it is of fundamental importance to not be deprived of its contractual right to cancel according to mandatory provisions. From the lender's point of view it is predominantly a matter of being deprived their right to step in and opportunity to complete the project in question. The contractual right provided for in direct agreements is thus overtaken by the bankruptcy estate, which may compel the solvent party to performance.

Besides, the project contract and future claims are subjected to security in favour of the lenders that will be lost if the contracts are cancelled. How security is handled in the course of bankruptcy is not clear. Considering future claims, the value is deprived in a bankruptcy according to the “freeze principle”, however with regard to contracts in general and various forms of license and the factual concession contract it is not clear. This enquiry is essential as well, the possibility for the lenders to claim security over the concession contract and in case of bankruptcy enforce such right – hence not a right to the future revenues but a factual right to complete the project, could provide an efficient alternative and hence prevent the estate from entry. However, this enquiry is outside the scope of this essay nevertheless here recommended to be subjected to further scrutiny.

Apparently, the efficiency of direct agreements is of fundamental importance with regard to project finance. If the debtor’s estate is entitled to enter into the debtor’s agreement the efficiency of direct agreements is hampered, hence the objective of this essay is to examine whether the debtor’s estate is entitled to such right.

3.2 English law

Direct agreements are negotiated in the light of English law where the debtor’s estate entry into the contracts is not a matter of concern. English security law have been weighted very heavily in favour for secured creditors. Not only did secured creditors rank ahead of unsecured creditors on insolvency, but secured creditors who held a qualifying floating charge could effectively control the manner in which their security was enforced. English law entitle the lenders to step in and enforce their security by means of taking over the business of the debtor and run it on behalf of them selves, without taking notice of other unsecured creditors. The relevant legislation allowed a secured lender who had the right to appoint an “administrative receiver” to effectively block the appointment of an administrator.¹⁵ The right to acquire the debtors business may thus not be possible without permissions and constant from third parties. Accordingly, direct agreements were intended in this regard, in order to make their extensive enforcement remedy effective.

Step in rights does not necessarily need to be exercised as a means of, or in conjunction with the enforcement of security, however this is the basic principle behind the objective of direct

¹⁵ See the old 22.9(3) and 29(2) of the Insolvency Act 1986. This point of law has been preserved, at appropriate places in Schedule B1 to the IA, in relation to the exceptions where an administrative receiver can still be appointed, see below.

agreements. Another question outside the scope of this essay, however of essential importance for the efficiency of direct agreements, is thus how the aggressive management or control purpose can be exercised in jurisdictions with no receivership remedy, such as in Sweden. The primary purpose for the lenders is to run the debtor's business and hence not to enforce their security, the way we are used to in Sweden.

Besides to either stepping in directly themselves or trying to transfer the project to a work-out vehicle is subjected to inconvenience. A novation of the entire project contract may be of no use if it is not possible to transfer the project assets as well. Albeit it can be submitted that is not in contention whether security can be taken over all the asset of the project company, the transferring a business from one company to another may be more of a theoretical than a real right, because of the sheer volume of legal work that may be involved in such transfer.

If, in the case of a jurisdiction with no receivership remedy, the banks can get comfortable with the possible liabilities that might result from an enforcement of any security they may have over the project company's shares and can take over control of a project in this manner. Such course of action would be fraught with potential direct liability for the banks. In a civil law jurisdiction limited enforcement remedies, it may thus be difficult to establish the basis of the banks' rights to bring about the novation of a project contract. If the basis is simply a contractual agreement with the project company coupled with agency, this may be vulnerable if the project company is insolvent. The different means for the lender's to step in and obtaining control over a project, that are likely to be in accordance with Swedish law, particularly in relation to the Company Act, remain uncertain and is thus here recommended to be examined further. Besides, these aspects have been subjected to extended negotiations when contracting PPP projects in the Nordic countries.¹⁶

However, English security law underwent a dramatic change on 15th September 2003 when the new section 72A of the 1986 Insolvency Act (and related provisions in the Enterprise Act) came into force.¹⁷ From this date, the holder of a qualifying floating charge in respect of a company's property may not appoint an administrative receiver of the company save in the

¹⁶ Consultation with Agne Sandberg company lawyer at Skanska

¹⁷ Section 72 (A)(1) of the Insolvency Act 1986 (inserted by s. 250(1) of the Enterprise Act, and Part 10 of the Enterprise Act 2002

case of certain exceptions.¹⁸ Three of the exceptions relate directly to project finance and public-private partnership projects and hence the appointment of an administrator may still be blocked for these particular cases. Apparently the lenders may still control the manner of the enforcement remedy and prevent the administrator from accede to the contracts.

3.3 Background

Swedish law do not contain any uniform rules on the effect of an insolvency proceeding on the debtor's contracts. In fact, there is a dearth of general rules in this field. There are no generally worded legal rules concerning the procedure to be followed when the bankruptcy state wishes to fulfil, or actually does fulfil the debtor's contracts. Swedish law contains only isolated regulations for certain special types of contracts. Mention may primary be made of rules for sale of goods and usufruct of real property.¹⁹

The reason behind this fragmented regulation may be traced back to the joint Nordic revision of material bankruptcy law at the beginning of the 1970's, where the question arose of the introduction of a general legal regulation of this field. Sweden however refrained from submitting proposals thereon, because general provisions were considered to not satisfy particular circumstances in different types of contracts. The transfer of operations to a liquidator was held to be a factor which, in certain however not in other contractual relationships may result in such erosion in the other party's conditions for the agreement that it is not deemed reasonable that the estate accede to the agreement.²⁰

Denmark and Norway, on the other hand, considered that the need for explanatory rules outweighed such objections. Thus, in contrast to Sweden, both these countries introduced overall rules on the subject. The Norwegian insolvency law incorporate rules both with regard to bankruptcy as well as corporation rehabilitation. The law underwent legislative changes in 2000 in order to improve the coordination of these two proceedings. The basic principle according to Norwegian and Danish law is that insolvency on its own does not terminate

¹⁸ ss.72B – 72GA of the IA 1986

¹⁹ See, for example, section 63 of the Sale of Goods Act; Chapter 4, section 26, Chapter 8, section 17, Chapter 9, section 30, and Chapter 12, section 31 of the Land Code; section 47 of the Commercial Agents Act; section 27 of the Commercial Representatives Act; Chapter 2, section 27 and Chapter 4, section 7 of the Partnerships and Non-registered Partnerships Act; and sections 26 and 28 of the Insurance Contracts Act.

²⁰ See SOU 1970:75 p. 55 to the right, Håstad, Sakrätt avseende lös egendom, 6 uppl. 2000, p. 401

contracts, hence the debtor estate is entitled to accede to the debtor's agreements save in the case of certain exceptions, where the nature of the legal relationship otherwise require.²¹

3.4 Need for reform

The fragmented regulation in Sweden has thus resulted in uncertainty regarding the estate's right of accession both in regulated and unregulated contractual relationships.²² Besides, in 1996 the company reorganisation implemented mandatory right for the debtor's estate to enter into the contracts, even with regard to partial entry, which is in violation of earlier case law.²³ The two proceedings fail to be in accordance with each other which have proved to reduce the efficiency of the law of company rehabilitations.

The need for reform is firmly expressed in legal doctrine as well as in public documents and the subject has been highly debated during the latest years. Inconvenience with regard to insolvency law is however not solely a locally restricted dilemma thus recognised all over Europe. Lack of consistency and systematically give rise to problems establishing *de lege lata*. However the expressed need for reform predominantly refers to the interest of company reconstruction. Apart from the interest of all creditors, attention is now paid to the interest of safeguarding the debtors business and socio-economic cum labour market policy.²⁴

This trend may have serious implications with regard to project finance and private public partnership. However in England, as demonstrated above, exceptions have been made for some certain cases, including project finance. Besides, in Norway exceptions from the basic principle of the estate's right of entry have been carved out particularly with regard to private public partnership within the transport sector concerning construction of roads.

However, so far the Swedish legislatures have not made any improvements or elucidated the matter. A public investigation was published in 2001 suggesting a number of legislative reforms however the proposal has not yet given rise to concrete legislative changes.²⁵ Reasons for this delay is held to be because of a coming proposal of incorporating the

²¹ Lov av 8. juni 1984 nr 58 om Gjeldsforhandling och konkurs (konkursloven), förarbete: NOU 1993:16 and Ot. Prp. Nr 26 (1998-99), Dekningsloven § 7:3 2 st

²² Håstad, Sakrätt, p. 401, SOU 2001:70

²³ See for instance NJA 1989 s 206, the so called "Piccolo Mondo" case.

²⁴ See for instance Möller, Konkurs och Kontrakt, 1988 (Möller, 1988), Tuula, 2003 p. 130, Håstad, Sakrätt, SOU 2001:80 p. 24-25 etc.

²⁵ See for instance Håstad, Sakrätt p. 401- 402 and SOU 2001:80.

bankruptcy and the rehabilitations process into one coordinated insolvency proceeding. With regard to bankruptcy, the proposal was also held to be inadequate; the rules were described as solely sketches.²⁶ Directives for further investigations of a coordinated insolvency proceeding is expected in March or April 2006.²⁷

3.5 Contractual or bankruptcy perspective

The legal uncertainty is thus upheld by the fact that two diverse perspectives are presented in legal doctrine, the property and bankruptcy perspective as opposed to the contractual. Above all, as commentators representing both perspectives emphasize, it becomes a matter of balancing the to some extent conflicting interests that comes into play when one party to a contractual relationship is declared bankrupt and the bankruptcy estate wishes to continue the contract, i.e. the interest of the bankruptcy estate and its creditors as opposed to the interest of the solvent party.²⁸

According to the primer the maintenance of the debtor's estate should be upheld with the view to obtain a financially advantageous liquidation, preferably via continuation of the business and selling it as a going concern. The interest of the bankruptcy estate and the other creditors is thus upheld as cancellation may deprive the debtor of a profitable contract producing a gain for the estate and that also may be essential for a rescuing of the debtor via rehabilitation proceeding. The solvent party should not be entitled to use the insolvency as a mean to cancel onerous contracts or use the threat of cancellation in order to force the debtor's estate to performance. Hence, the creditors must be protected from the debtor's counterparties wanting to abandon from onerous contracts since this would give them an unjustified preference in the bankruptcy.²⁹

According to the latter point of view, thus primary taking the interest of the solvent party into consideration, the debtor's estate should not in any case be entitled to be in a better position than the debtor were previous to the bankruptcy. Where the debtor has breached the contract and the breach entitles the solvent party to cancel, the creditor may cancel as against the debtor's estate as well, even though security or claim is provided. From this contractual

²⁶ SOU 2001:80 p. 217.

²⁷ Uppgift från justitiedepartementet den 30 januari 2006 av Mina Lunqvist.

²⁸ See for instance Hellner, *Speciell avtalsrätt II:2*, 3 uppl, Allmänna ämnen, tredje upplagan, 1996, p. 81 ff, Tuula, p. 21 ff, Möller, p. 39 ff.

²⁹ Hellner, *Speciell avtalsrätt II:2* p. 83, Tuula, p. 22, Wood, *Project Finance*, p. 66.

perspective the basic question is thus if the solvent party may cancel an agreement in the course of the counterparty's bankruptcy.³⁰

The basic distinction ensuing from these two points of departures is thus if the rules are to be considered as mandatory or discretionary. Apparently, the bankruptcy perspective implies the rules to be considered as an imperative right under the bankruptcy law, hence an agreement concerning the right of cancellation by the solvent party is of non effect against the bankruptcy state. The contractual perspective, on the other hand, is of discretionary character and hence entitles the solvent party to contract terms beyond the scope of the Sale of Goods Act in the course of bankruptcy.³¹

4. Analyse with regard to the project contract

4.1 Point of departure

The contracts that may be subjected to direct agreements varies and thus comprises a whole range of agreements such as concession, construction and general sale agreements. However, as indicated above, the agreement entered into between the public party and the project company is the most important contract due to its implied ability to secure future revenues and the prescribed right to build the project in question. Besides, the most fundamental security for the financiers is taken over this particular contract (i.e its future revenues). Hence, the estate's right to entry is predominantly examined with regard to this contractual relationship however knowledge and understanding of the entire context is essential. Besides emphasis is made to the analysis of applicable law with regard to project finance, hence the conflicting views expressed in legal doctrine are chiefly presented in conjunction with the general analysis.

Since private public partnership so far is not in use in Sweden, there is no regulation, nor case law nor legal doctrine on the matter. The agreement entered into between the public party and the project company thus comprises an unregulated contractual relationship. It is acknowledged in legal doctrine that uncertainty often prevails regarding the estate's right of accession in unregulated cases. Despite implied inconveniences, this legal uncertainty brings

³⁰ Håstad, Sakrätt. p. 402.

³¹ Hellner, Speciell avtalsrätt II:2 p. 89.

about room for argumentation with regard to project agreements. Both the extent to which a bankrupt's estate has a right of accession in unregulated cases as well as whether the estate's right of accession is mandatory when such occur is subjected to uncertainty.³² These two uncertain factors are thus taken as point of departure in the analysis of the legal situation with regard to project agreement in PPP.

Besides, these two factors have bearing on the efficiency of the lender's right to step in, hence the quandary may be examined from two different perspectives. Firstly, the lenders are free to step into the contract provided that the solvent party is entitled to cancel in course of bankruptcy. (According to the terms in the direct agreement, the solvent party is prevented from cancelling, thus in practice the contract is novated from the solvent public party to the "additional –" or the "substitute obligor" without the contract being cancelled, however such perception provides a theoretical means to avoid the right of the estate to enter into the debtors agreements.) Secondly, the lenders may hypothetically wish to exercise the rights provided for in direct agreements, directly in the bankruptcy against the estate.

The two basic questions to be examined is thus firstly whether *de lege lata* entitles the project company's bankruptcy estate to enter into the project agreement and compel the public counterparty to performance (and prevent the lenders from exercising their step in rights), or expressed from a contractual perspective, whether the solvent public party is entitled to cancel. Secondly, wheatear an agreement interfering with the right of the debtor's estate, such as an assignment of the contract to the lenders, as prescribed in direct agreements, is effective against the estate.

As for unregulated cases in general, analogies to particular set of laws, case law and general contractual, bankruptcy and property law principles must be made.³³ Appropriate guidance may be given from general principles on performance of non-monetary obligations. Besides, project finance has essential features in common with construction agreements, which conversely have been subjected to extensive debate in legal doctrine. Particular attention is paid to the legislative reform conducted in Norway as well.

³² See for instance SOU 2001:80 p. 24, 25.

³³ Tuula, p. 23-24, SOU 2001:80 s. 81, Hellner, Speciell avtalsrätt II:2, p. 92.

4.2 Analogy to individual acts

The individual acts under Swedish law that contain provisions relating to the contractual relationship affected in case of bankruptcy prescribe different models on how bankruptcy affects the debtor's contract. The starting point must be taken in the Swedish Sale of Goods Act (SGA). Subsequent to legislative changes in 1990, the current wording of paragraph 63 entitles both the buyer and the seller's bankruptcy estate to enter into the debtor's contract.³⁴ This provision lays down the basic principle of the right of the estate to accede to the debtor's agreement. The same principle applies with regard to the tenant's bankruptcy in case of rental of non-residential property. Provided that security is offered, the bankruptcy estate is thus given a mandatory right to prevent the solvent party from cancel.³⁵

Some individual acts on the other hand prescribe that the contracts in question cease to endure immediately as a consequence of the bankruptcy, such as commission contracts and some association contracts.³⁶ The same principle applies with regard to insurance agreements however subsequent to certain delay.³⁷ On the contrary, according to some provisions the solvent party is given an unconditional right to cancel in the course of the other party's bankruptcy.³⁸

The first question is thus whether analogy may be made directly to an individual act prescribing right for the solvent party to cancel. Apparently, the provisions provided in legislative acts are sometimes contradictory without the contradictions being susceptible to any reasonable explanation.³⁹ It is thus hard to make certain analogies to particular sets of laws. No individual act appears to be suitable for direct analogy. The analogy that appears to prevail in doctrine with regard to most unregulated contractual relationship is the basic principle ensuing from the 63 § Sale of Goods Act. Besides, the Sale of Goods Act is held to be an expression of general contractual principles and thus convenient as analogy to other types of contracts.⁴⁰ Despite the preference given in doctrine in favour of the estate right to accede to the debtor's contracts the contractual interest of the solvent party appears to have

³⁴ 63 § 1 st. SGA.

³⁵ See chapter 12 section 31 Land Code, see as well, 8:17, 9:30, 4:26.

³⁶ See section 47 of the Commercial Agents Act, section 27 of the Commercial Representatives Act

³⁷ sections 26 and 28 of the Insurance Contracts Act.

³⁸ See for instance chapter 9, section 30 Land Code and Chapter 2, section 27 and chapter 4, section 7 of the Partnership and Non-registered partnership Act. (SOU 2001:80, p. 85).

³⁹ See as well SOU 2001:80 p.

⁴⁰ See for instance Hellner, *Speciell avtalsrätt* II:2, p. 84.

strong impact on the development in case law (see NJA 1989 p. 206 see as well 2001 p. 99). Reform is held not to be carried out without legislation (see NJA 1999 p. 617).⁴¹

There are not many unregulated contractual relationships that in doctrine is definitely held to deviate from the general principle, solely in analogy with particular individual acts. Where exceptions are held to be likely, other forms of legal techniques are generally applied. However, for some particular cases such direct analogy has been made, mention may primary be made to financial leasing. Financial leasing is in legal doctrine held to represent a unique type of contract and consequently the rules of the Sale of the Goods Act are not directly applicable. Instead analogies are held to be sought in the rules for sale of goods and for rental property.⁴² It is held that since the estate, according to the provisions for these two contractual relationships, has a right to accede to debtor's contract, the same principle should apply with regard to financial leasing as well. Appreciably certain interests in conjunction with financial leasing are besides taken into consideration.⁴³

4.3 The basic principle

Apparently, Swedish law opens up for making analogies to other sets of law than the Sale of the Goods Act. It is likely to argue that construction contracts comprises an unique type of contractual relationship and hence in analogy with commission contracts for instance, bring about exception from the basic principle and provide the solvent counterparty with an unconditional right to cancel. However it is doubtful if such argumentation prove successful. Hellner emphasis that with regard to long-term agreements analogies may be made to §§62, 63 of Sale of Goods Act, § 47 Commission law and to general principle with regard to cancellation due to essential ground, however points out that analogy to 63 § Sale of Goods Act prove *in dubio* to be the most convenient.⁴⁴

The principal rule acknowledge in doctrine, that most likely is to apply with regard to construction contracts in project finance as well, is thus to make analogy with the Sale Goods Acts and hence stating that the debtor's estate is entitled to accede to the contracts. Unlike the provision under Norwegian law and in several other jurisdictions, exceptions may not be

⁴¹ SOU 2001:80, p. 25.

⁴² Möller, 1988, p. 442 ff.

⁴³ SOU 2001:80 p. 87, see as well Tuula, p. 87 ff, Möller, *Civilrätten vid finansiell leasing*, 1996, p. 255 and 266 f and SOU 1994:120.

⁴⁴ Hellner, *Speciell avtalsrätt II:2*, p. 92, See as well Hellner, *Inslvensrättsligt forum* 1990, p. 213.

made solely due to the nature of the contractual relationship. However, it is acknowledged under Swedish law that exceptions may be made in analogy with the contractual principle of anticipatory breach ensuing from 62 § Sale of Goods Act.⁴⁵ The extent to which this provision is applicable is thus in contention.⁴⁶

4.4 Anticipatory non-performance

Due to the considerably inconvenience that the wording of section 63 of the Sale of Goods Act (SGA) may cause the buyer in the course of the seller's bankruptcy, exceptions have been acknowledged in the preparatory works. The explanatory works emphasize that the general contractual principle of anticipatory breach ensuing from the provisions under section 62 of the Sale of the Goods Act shall apply in course of bankruptcy as well.⁴⁷ Where the performance is dependent on particular circumstances from the seller himself, the solvent party may cancel, such as a personal contracts requiring personal skill. It is thus held that the solvent party should be entitled to cancel in cases where there will be a fundamental breach of contract because the estate lack preconditions to perform contractually.⁴⁸

The wording of section 62 of SGA correspond to the CISG article 72, thus giving the solvent party a noticeably right to cancel in case of anticipated breach. General requirements acknowledged with regard to anticipatory breach are that it should be clear that there will be a non-performance, a suspicion, even a well-founded one is not sufficient. Furthermore, it is necessary for the non-performance to be fundamental.⁴⁹

Hellner emphasize that these preconditions in general should be satisfied in the course of bankruptcy thus arguing that the bankruptcy *per se* constitute an anticipatory breach. However, he stress that it is doubtful wheatear the advantages for the bankrupt's estate, ensuing from section 63 of SGA, may be eliminated by invoking its section 62. Hellner emphasize that section 63 of SGA comprises a restriction compared to the far-reaching right in favour of the solvent party prescribed in section 62 of SGA.⁵⁰ The requirement of section 63 of SGA is "certain reasons" as opposed to the general right implied in section 62, besides, the

⁴⁵ SOU 2001:80 p. 86.

⁴⁶ See for instance Hellner, *Speciell avtalsrätt*, II:2, p. 90-91, and below

⁴⁷ Prop 1988/89:76 p. 182 ff.

⁴⁸ Prop 1988/89:76 p. 183.

⁴⁹ See for instance Ramberg, *Köplagen*, p. 598, Hellner, *Speciell avtalsrätt* II:2, p. 87, *Unidroit Principles of International Commercial Contracts*, Article 7.3.4 with comments, p. 226.

⁵⁰ Hellner, *Speciell avtalsrätt* II:2p. 90, 91.

latter require extended timeframe (“immediately or without delay” (“genast”) according to section 62 as opposed to “without unreasonable delay” (“utan oskäligt uppehåll”). Hellner presumes the meaning of the proposition to be that the solvent party may cancel provided that other reasons than the insolvency is invoked to anticipate the breach. The law provisions do not distinguish between different forms of anticipated breaches.⁵¹

4.5 Deviations from the basic principle

It appears that the basis behind the individual sets of laws deviating from the basic principle of the estate’s right to accede to the contracts and exceptions acknowledge in analogy with anticipatory breach correspond. The individual acts that prescribe exceptions from the general principle have some features in common and hence may give some guidance on likely exceptions. Möller emphasis that the basis for these rules distinguishes from the general considerations made in the Goods of the Sale Act and the Land Code. An essential element in this regard is held to be that the contractual relationships typically are of a personal nature, relying on trust and confidence. Möller argues that the counterparty’s insolvency for these particular contractual relationships indicate that an essential precondition for the due performance is wanting.⁵² There are very few unregulated contractual relationships that in doctrine, with certainty, are held to be exceptions, mention may primary be made to pure credit agreements. However vast degree of uncertainty is held to subsist with regard to construction contracts and patent licence contracts.⁵³

Apparently, deviation from the basic principle may not be acknowledged solely due to the insolvency or bankruptcy. However exceptions appear to be likely where the contract is of personal nature.

4.6 Construction contracts and non-monetary performance

Albeit the particular contractual relationships to a project company have not been deliberated in legal doctrine such relationships have a lot in common with complex sale agreements and construction contract that conversely have been subjected to extended debate, in Sweden as well as in the Nordic countries and in Germany. The reason behind the extensive literature is connected to the generally recognised problem where a non-monetary obligation is to be performed by a third party. Hence, in essence the project company is to perform a non-

⁵¹ Hellner, Speciell avtalsrätt, II:2. p. 90, 91.

⁵² Möller, Insolvensrättsligt forum, 22-23 januari, 1990, p. 202.

⁵³ SOU 2001:80 p. 208.

monetary obligation which brings about the quandary of the treatment of the seller's and the entrepreneur's contractual non-monetary obligations in case of their bankruptcy. The matter is of paramount concern particularly due to the frequency of standard contracts and agreements prescribing an unconditional right for the solvent party to cancel in course of bankruptcy.

Sweden has no general laws on construction contracts. The standard contract "Allmänna bestämmelser för byggnads-, anläggnings och installationsentreprenader" (General regulations for Building, Construction and Installation Contractors) (AB 92) instead holds pride of place. Following the legislative reform in the Sale of Goods Act, AB 72 underwent similar changes in 1992. In contrast to the wording of the 1972 version and in accordance with the Sale of Goods Act, the clauses give both the client's (the future proprietor) as well as the entrepreneur's bankruptcy estate right to enter into the contracts provided that security is offered.

The contemporary legal situation with regard to the entrepreneur's bankruptcy is fluid, however, most commentators suggest in analogy with the Sale Goods Act and in accordance with the standard construction agreement, AB 92, that the entrepreneur's estate is entitled to accede to the debtor's contract. This is considered as pertinent due to the fact that the SGA entitles the bankruptcy estate to enter albeit the performance in question concerns complex construction agreements. However, the legal uncertainty is accentuated.⁵⁴ Besides, it is held that the general principle of anticipated breach ensuing from 62 § of the Sale of the Goods Act is applicable with regard to construction contract and the entrepreneur's bankruptcy as well.⁵⁵ Consideration to certain aspects in individual cases may thus be satisfied within the scope of anticipated breach.

Preparatory works and contemporary legal literature make frequently references to the thesis of Möller, albeit legislative reforms have been made subsequent to his work.⁵⁶ Möller base his thesis on Nordic and German legal literature to a large extent. Notwithstanding that Swedish law do not lay down general rules on the matter, the legal situation appears to correspond to the Nordic rules to a significant extent. The key argument invoked in favour of the solvent party to cancel with regard to construction contracts, is that the attribute of the

⁵⁴ See i.e. SOU 2001:80, p. 86, 87.

⁵⁵ See for instance SOU 2001:80, p. 87 and p. 209, Hästad, Sakrätt, p. 405.

⁵⁶ SOU 2001:80, p. 222.

entrepreneur often is held to be of personal nature. Particular concern is also held to be due to the likely risk of key employers to leave in course of the debtor's bankruptcy. Håstad stress that the debtor's estate may have problems keeping employers and hence not be able to complete the construction work in time and without defaults.

In Norway, the same principle as expressed in AB 92 has prevailed, hence, the entrepreneur's bankrupt's estate is entitled to enter into the contract provided that the estate can show that it has sufficient financial and cognitive resources to complete the work contractually.⁵⁷ However, the general exception prescribed in Norwegian law acknowledges the insolvency to be invoked as a mean to cancel where the contractual relationship is of certain nature. In Germany on the other hand, it was established in case law in 1985 that the predominantly standard contract's right of cancellation in the event of the building contractor's bankruptcy is effective against the latter's bankruptcy estate. This is justified on the ground that the entrepreneur's personal attributes are so important that the estate may not be allowed to complete the works in accordance with contracted terms. Moreover, the mutual trust on which the contractual relationship is based is impaired by the bankruptcy and a liquidated business is said to be incapable of fully assuming the entrepreneur's guarantee responsibility for defects.⁵⁸

4.7 Contract of personal nature

Guidance on the "traditional" meaning of personal attribute may be given from international sources such as Unidroit Principles and is here expressed to be related to the obligor's specific qualifications (see the comments on Article 9.2.6).⁵⁹ Performance of an exclusive personal character is in article 7.2.2 held to be when it is not delegable and requires individual skill of an artistic or scientific nature or if it involves a confidential and personal relationship.⁶⁰

However, such traditional arguments referring to personal attribute of the debtor, is unlikely to apply concerning the particular circumstances at stake in private public partnership. None of these preconditions is pertinent with regard to the project company. Essential features distinguishing private public partnership from the arguments invoked in relation to

⁵⁷ NOU 1972:20 p. 314, Ot prp nr 50 (1980-81) p. 184, see as well Möller 1988, p. 262, ref to Braekhus p. 174

⁵⁸ BGH 26.9.1985 (ZIP 85.1509) see Möller 1988, p. 264

⁵⁹ Unidroit Principles of International Commercial Contracts, Article 9.2.6, comment p. 298.

⁶⁰ Unidroit Principles of International Commercial Contracts, Article 7.2.2 Performance of non-monetary obligation, Comment 1, p. 210.

construction contracts is that the project company in general solely comprises an empty “shell company” without own employers etc. Hence, it is not the project company who carry out the work, this is done by subcontracting parties. Arguments that key employers tend to leave in the course of bankruptcy may be applicable, however, in this regard referring to the workers employed by the subcontracting parties.

Whether the performance of the project company could be characterised as personal have been subjected to scrutiny in the explanatory work to the legislative changes brought about in the Norwegian Road Act, (“Veglova”), where exceptions from the principal rule have been carved out in relation to public private partnership projects for (the construction and maintenance) of public roads. However, the idea was here rejected. It is first held that there are many companies competing in order to obtain the concession and thus competent to perform the contract. The most important objection in this regard is however held to be the factual step in rights themselves. In accordance with the international principles referred to above, an essential element in determining personal nature is whether the contract is transferable.⁶¹ Step in rights thus proves that the contract is transferable. Besides, it is submitted in the Norwegian explanatory work, that since the project company does not carry out the project work on its own, the bankruptcy estate may employ exactly the same subcontractors as the project company.⁶²

However, it must be invoked that the solvent party does not entitle the project company a general right to assign the contract, on the contrary, this right is solely held in favour of the lenders and provided that certain requirements are met. Indeed, the project agreement contains clauses preventing the project company from assigning the contract. The transfer is thus surrounded by control and particular conditions that the bankruptcy estate may not be able to fulfil.

4.8 Economical aspects and long-term contracts

However, there are several other aspects beyond personal skills that may render the contractual relationship personal. Notwithstanding the project company does not perform the contracted work itself, the public party base the decision of who to grant the concession on a number of factors. Möller claim that the entrepreneur’s skill is important in this regard,

⁶¹ Unidroit Principles of International Commercial Contracts, Article 7.2.2.

⁶² Vegdirektoratet, 20. desember 2005 UTKAST TIL ODELSTINGSPROPOSISJON: Om lov om endringer i veglova, (“Vedlegg 201205”) p. 3.

however, emphasis that his economical preconditions and the duration of the work are of significance as well.⁶³ The project company's economical stability may thus be considered as a personal attribute of essential importance for the public party's decision, a factor that increases with the duration and complexity of the project.

It appears that anticipatory breach may be invoked on a different ground than the "traditional" meaning of personal nature, rather in accordance with the reasoning of Möller, when he elucidates the basis behind the individual acts that deviates from the basic principle.⁶⁴ Hence, the debtor's insolvency may for certain contractual relationships denote that an essential precondition for the due performance is wanting.⁶⁵ It must thus be examined whether the solvency of the project company can be said to comprise an essential precondition for the due performance, against the background of the particular nature of project finance and public private partnership.

It is clear that the bankrupt estate does not have the equivalent economical stability as the project company, and is unlikely to prove adequate assurance of human resources due to the extended duration and costly project. The estate is generally not skilled to complete the work on its own and hence assignment to third parties is common or even compulsory. Assignment requires consents from the solvent parties and is besides according to contracted terms not permitted. Furthermore, where the contracted warranties go beyond the predicted duration of the bankruptcy, which is almost certainly the case for such long-lasting contractual relationship as in project finance, assignment is definitely obligatory. Albeit the enquiry of consent may be considered as a practicality, and hence not preventing the estate from entry, it may in this regard have significant legal implications. Apparently, if assignment is compulsory however not permitted the estate can not guarantee due performance. Möller support this "rule of evidence":

"Om boet beräknas ha avvecklats innan entreprenaden färdigställts, kan inte boet visa att de kommer att klara av att fullgöra entreprenörens förpliktelser enligt avtalet. Beställaren skulle då kunna häva redan på den grunden."⁶⁶

⁶³ Möller, 1988, p. 292.

⁶⁴ See above, Möller, Insolvensrättsligt forum, 22-23 januari, 1990, p. 202.

⁶⁵ Möller, Insolvensrättsligt forum, 22-23 januari, 1990, p. 202.

⁶⁶ Möller, 1988, p. 298

Apparently, provided that the contracted warranties goes beyond the predicted duration of the bankruptcy, the estate can not guarantee due performance. Apart from necessary consents, legal permissions are generally required as well, which the bankrupt's estate is unlikely to obtain since it is not skilled and not suitable to complete and operate the project. It is thus likely that the Swedish legal situation acknowledge further aspects than prescribed in the Norwegian explanatory work, to be taken into account when determining personal attribute.

4.9 Analogy to Norwegian law

Albeit the legal appraisal in the explanatory work to the new wording of the Norwegian Road Act, hastily rejects the idea of the contractual relationship to be of personal nature, it is here held that consideration to economical aspects and the duration of the contract, are more likely to be acknowledged on another basis, ensuing from the general exception prescribed in the Bankruptcy Act.⁶⁷

In order to understand the wording of the Norwegian explanatory work to the Road Act, it is necessary to examine the general applicable Norwegian Bankruptcy Act further. The general principle in Norway, as presented above, is that insolvency on its own does not terminate contracts.⁶⁸ The solvent party is however entitled to invoke the insolvency as ground for cancellation, if the contractual relationship is of certain nature.⁶⁹ Two examples are provided in the explanatory work to the Bankruptcy Act in this regard. Firstly, it is held that "it may for certain types of contracts be in the nature of the contract that the insolvency comprises a relevant wanting condition". Secondly it is held that exceptions from the right of accession may be approved where the contract is of personal nature, hence, where the debtor is entitled to prevent other parties from performance it is held to be reasonable that the debtor's estate is to be prevented as well.⁷⁰

Apparently, it is rather clear that performance of the project company can not be considered as personal under Norwegian law due to the lender's right to step in. Since the lenders are entitled to step in and hence other parties are not prevented from performance, neither should

⁶⁷ Lov av 8. juni 1984 nr 58 om Gjeldsforhandling och konkurs (konkursloven), förarbete: NOU 1993:16 and Ot. Prp. Nr 26 (1998-99).

⁶⁸ Lov av 8. juni 1984 nr 58 om Gjeldsforhandling och konkurs (konkursloven), förarbete: NOU 1993:16 and Ot. Prp. Nr 26 (1998-99).

⁶⁹ Dekningsloven § 7:3 2 st.

⁷⁰ NOU 1972 :20 p. 309 ff, Vedlegg 20120, p 4.

the debtor's estate be deprived of its right to compel performance. Whether assignment is likely to occur is thus a deterrent condition.

On the other hand, the secondly example provided in the explanatory work, hence whether the particular nature of the project agreement may render the insolvency of the project company to an essential wanting condition, appears more appropriate. Consequently, the insolvency of the project company may *per se* constitute an anticipated breach on the basis that an essential precondition for due performance is missing.

However, it is uncertain whether Swedish law acknowledge such argumentation to be invoked in order to constitute anticipatory breach. It is articulated in Swedish preparatory work that the solvent party can not prevent the estate from entry solely due to the fact that the debtor's person is significant for the due performance, as in Norway and Denmark.⁷¹ The Swedish proposition does not comment upon the economical attribute of the debtor or contracts of long-term duration. It is however held that the solvent party is not required to accept performance from the debtor's estate in all circumstances. In general terms, it is held that the debtor's estate should not be entitled to compel performance where this implies disadvantages for the solvent counterparty. However, examples provided in this regard, as indicated above, are where the seller's personal attributes are of certain importance such as personal knowledge and skill. It is held that the solvent party should be entitled to invoke anticipatory breach according to the 62 section in SGA "in such and similar cases".⁷²

Nevertheless, exceptions are to be acknowledged to the same extent as in Norway, in analogy with the Norwegian law provision, the outcome with regard project finance is far from clear. Whether exceptions for private public partnership should be approved, according to the second example prescribed in the Norwegian proposition of the Bankruptcy Act, have been subjected to scrutiny in the explanatory work to the new wording of the Road Act. However given the fact that a law reform has been implemented the outcome of the appraisal is rather predictable.

⁷¹ SOU 2001:80, p. 86.

⁷² Prop 1988/89:76, p. 182 ff.

4.9.1 The reason behind the Norwegian legislative reform

The wording in the law proposal to the legislative reform in “veglova” somewhat supports the idea that the insolvency of the project company may be regarded as an essential missing precondition due to the extended and durable obligation, however concludes that uncertainty prevails.

References are made to the general preparatory work that lay down the basic principle of the estate’s right to enter. These papers comment upon long-term contracts and contracts that are subjected to extended future payments (from the estate) and it is held that considering the estate’s duty to provide security it should be possible to entitle the estate a restricted right to entry into such contracts as well. *“Med de regler om boets plikt til å stille sikkerhet og boets oppsigelsesadgang som er oppstillet i §§ 7-5 og 7-6, skulle det etter utkastet være mulig å gi boet en rasjonelt begrenset rett til å tre inn også i kontrakter av disse typer”*.⁷³

This wording is interpreted in doctrine not to principally prevent the estate from entry in such cases. It is held that the public counterparty is not entitled to prevent the estate from entry solely on the basis of the long-term and extended nature of the project contract referring to the exception “the art of the contract” (in dekningsloven § 7-3, 2 st.) This is considered as reasonable due to the legal obligation for the estate to provide security.⁷⁴

However, it is recognised in general legal theory that the solvent party should be entitled an extensive right to cancel long-term contracts in the course of bankruptcy. The law proposal (in “veglova”) refers to Sandberg who emphasise, in accordance with the wording of Möller referred to above, that the solvent party should be entitled to cancel where the contracted warranties goes beyond the predicted duration of the bankruptcy estate.⁷⁵ The same reasoning appears to prevail in Danish legal theory.⁷⁶ However the law proposal accents that it is not clear how these aspects, hence the extended right to cancel due to long-term contractual obligations, should be treated with regard to the duty to provide security. Since the estate is obliged to provide security if he decides to enter into the debtor’s contract, his right of entry is likely to be considered as reasonable.

⁷³ NOU 1972:20 p. 313, see as well Mads H. Andenaes, Konkurs, 1999, 2 uppl. p. 156.

⁷⁴ Vedlegg 201205, p. 4.

⁷⁵ Vedlegg 201205, p. 4, ref to Tore Sandvik, Laerbok i materiell konkursret, 1999, p. 593-594.

⁷⁶ Ref to Niels Orgaard, Konkursret, 1999, 7 uppl, p. 59.

The law proposal concludes that uncertainty prevails and hence that it can not be excluded that the estate is considered to have right to enter into the project agreement in private public partnerships.⁷⁷

4.10 Implication of the right to provide security

However, the same “vacant space” appears to prevail in Swedish legal theory both with regard to the general principle of anticipatory breach prescribed in section 62 SGA and with regard to the wording of section 63 SGA that lays down the principle of the estate’s right to accede to the debtor’s contracts, however provided that security is offered.

According to section 62 SGA, the party threatened by cancellation may avert such remedy if appropriate security is offered. Apparently, the solvent party is deprived its right to cancel ensuing from the anticipated breach, in accordance with section 62 (2 st), if the debtor provides security.⁷⁸ It is unclear under Swedish provisions to what extent security may prevent the solvent party from cancelling and how far-reaching security the estate is required to provide.

Explanatory work does not clarify how the two sections relate to each other, if the right to provide security may render the solvent party’s cancellation right according to section 62 of SGA ineffective. It is solely held that where performance is dependent on particular circumstances from the seller himself, the solvent party is entitled to invoke the principle of anticipated breach in accordance with section 62 SGA and prevent the estate from entry.⁷⁹ Neither do general principles ensuing from international sources give any comprehensive guidance, CISG do not deal with property rights.⁸⁰

Håstad emphasis that following the legislative changes in SGA and in AB 92, it is possible that the debtor’s estate is entitled to enter into the debtor’s agreements albeit the performance is of enduring and complicated nature.⁸¹

⁷⁷ Vedlegg 201205 p. 6.

⁷⁸ Prop. 1988/89:76, Köplag 180 m jfr 181 y and 184 y, Håstad, Den nya köprätten p. 187 footnot 9.

⁷⁹ Prop 1988/89: 76, p. 183.

⁸⁰ See Art 4(b) CISG, see as well Ramberg and Herre, Allmän Köprätt, 2 uppl, p. 118.

⁸¹ Håstad, Den nya Köprätten, 2003, p. 405.

As indicated above, Möller comments on long-term contracts, however subsequent to the legislative changes, it is hard to predict the contemporary legal situation. Despite the “rule of evidence” endorsed by Möller, implying that the estate can not approve due performance where the contracted warranties go beyond the predicted duration of the bankruptcy estate, he concludes that the bankruptcy estate normally should be entitled to fulfil the seller’s contracts even in such cases. For the protection of the buyer he suggest that an obligation is imposed on the seller’s bankruptcy estate to set aside funds for future warranty claims, unless it appears highly unlikely that that such will arise. Apparently, the new wording of the rules in the SGA, that entitles the bankrupt seller’s estate to compel performance, provided that security is offered, corresponds to the earlier arguing of Möller and thus implies that the right to cancel long-term and valuable contracts is likely to be deprived of the solvent party.⁸²

This outcome is criticised even by commentators in favour of the bankruptcy perspective. Håstad argues that the right of the solvent party has not been considered sufficiently in the new Goods of Sale Act. He stress that where the contract is considered as personal, security in terms of economical guarantee solely comprises a form of surrogate and hence can not be considered as satisfactory.⁸³ Where it is clear that the debtor's estate will not perform contractually, the solvent party should not be obliged to performance and to satisfy with a claim. Håstad suggests exceptions to be carved out, in the 63 § 1 st. SGA, in cases where it is clear that the bankruptcy estate will not perform contractually, hence in accordance with Norwegian and Danish law.⁸⁴

Besides, it is generally acknowledged and emphasised in legal doctrine both with regard to the seller’s and the entrepreneur’s bankruptcy that applicable rules may favour the bankruptcy estate to an excessively extent as opposed to the contrasting previous legal situation.⁸⁵

Commentators in favour of the bankruptcy perspective often hold that this enquiry is generally solved in the individual case due to the fact that the estate is not able to provide security and hence must deny its right to entry. Whether the estate should be entitled to so called partial entry has been settled in case law. It is submitted that the estate is not entitled

⁸² Möller, 1988, p. 298.

⁸³ Håstad, Den nya Köprätten, p. 405.

⁸⁴ Håstad, Den nya Köprätten, p. 405.

⁸⁵ See for instance SOU 2001:80.

such right.⁸⁶ Hence the security provided must correspond to the fully contracted period. Noticeably, entry may be practical impossible due to the likely risk that the estate lack resources to provide security. However, these aspects are simply of practical importance and do not prevent the estate from the legal right to enter. Ramberg argues that the debtor in general should not be required to provide extended security, hence if he were able to do so, he is unlikely to have encountered insolvency problems in the first place.⁸⁷ The security provided is thus likely to be considered as satisfactory albeit it fails to correspond to the potential risk ensuing from such entry. Apparently, application of anticipatory breach in accordance with section 62 of SGA is subjected to a number of uncertain factors and hence the risk of entry is impending.

5. Mandatory or discretionary rules

The second basic question is now to be examined, hence wheatear an agreement interfering with the right of the debtor's estate, such as an assignment of the contract to the lenders, as prescribed in direct agreements, is effective against the estate. The bankruptcy perspective thus implies that rules affecting the debtor's contract on insolvency are to be mandatory in favour of the estate.

5.1 Different perspectives

The debate relating to the mandatory or discretionary character of the provisions predominantly drives from the fact that the clause that lays down the estate's right to enter is prescribed in the Sale of Goods Act, a law which according to its 3 § is discretionary.⁸⁸ This clause is an expression of the principle of freedom of contract, thus stating that the law shall not apply where the parties have agreed upon another solution. However, it is generally acknowledge that the principle of freedom of contract is subjected to a number of limitations. Mandatory rules as well as general principles with respect to party autonomy for instance, prevail over the discretionary content of the SGA.

Håstad supports the mandatory perspective and concludes, in accordance with Möller, that given the mandatory character of bankruptcy and property law provision in general, an

⁸⁶ see for instance NJA 1989 s 206, the so called "Piccolo Mondo" Case.

⁸⁷ Ramberg and Herre, Allmän Köprätt, 2 uppl, p. 156.

⁸⁸ Jmfr prop 1988/89:76 p. 323 f. (See as well Lindskog, Kvittning, Om avräkning av privaträttsliga fordringar, 1993, p. 172).

agreement can not deprive the estate's right to enter and hence such agreement is void against the estate. Hellner, on the other hand, advocates the contractual perspective and claim that the parties are free to determine the content of the contract. He stress that a well-weighted balancing of interests can be achieved by applying general contractual principle ensuing from section 36 of Law of Contract.⁸⁹

Lindskog argues that section 63 of the Sale of Goods Act may not be considered as mandatory due to the wording of section 3 of the same law. However, he implies that the estate's right to enter may be considered as an expression of a general legal principle ("allmän rättsprincip") and hence of mandatory character. He alleges, in accordance with Håstad, that an agreement solely aiming to treat other creditors unfairly is generally considered to be void.⁹⁰

On the other hand, the principle of anticipated breach is, in Sweden as well as internationally, recognised as a general legal principle as well. Hence, supporting the right of the estate to entry on the basis of general contractual principles is subjected to inconveniences. Two mandatory principles are thus in conflict without appropriate guidance on which one that should prevail.⁹¹

5.2 Agreement infringing third party's right

The essence of the debate, particularly demonstrated in German, Danish and Norwegian literature, is that an agreement may not infringe third parties' rights. It is held in Norwegian preparatory work that an agreement is solely binding upon the contracting parties and hence not effective against a third party – the bankruptcy estate.⁹² The risk is held to be impending, for the debtor and its counterparty to agree upon clauses at disadvantage for other creditors in the course of bankruptcy. Given the fact that the debtor will be deprived its right in the bankruptcy in any case, there is no incitement for the solvent party and the debtor to take the interest of other creditors into account, at time for their agreement. Hence the contracted clauses are unlikely to be at disadvantage for the debtor himself, however solely for the creditors.

⁸⁹ Hellner, *Speciell avtalsrätt*, II:2 3 uppl, p. 90, see as well Hellner in *Insolvensrättsligt forum* 22-23 january 1990, p. 198.

⁹⁰ Lindskog, *Kvitning*, Om avräkning av privaträttsliga fordringar, 1993p. 172.

⁹¹ See Tuula footnote 116, referring to Almén, T, *Om köp och byte av lös egendom*, kommentarer till lagen den 20 juni, 1924, s 591, the general principle has been accepted of Bengtsson, Hellner and Rhode. See Bengtsson, B, *Hävningsrätt och uppsägningsrätt vid kontraktsbrott*, 1966, Hellner, J, *Köprätt*, kortfattad lärobok, 4 uppl. 1974, 9 kap.

⁹² NOU 1972:20 p. 310 f.

Möller advocates the arguing in Danish and Norwegian legal literature and in conjunction herewith he considers the bankrupt estate to be on an equal footing with a “new third party”. Albeit the entry of the estate is not legally defined as change of debtor, Möller stress that comparison proves adequate.⁹³ Möller basis his arguing on the fact that assignment of debtor requires constant and hence is not permitted. However the bankrupt estate assume the debtor’s rights and obligations without obtaining such constant and hence the right of entry for the bankrupt estate constitutes, according to Möller, a “new imperative right” in favour of the estate.⁹⁴ Hence, in accordance with Norwegian preparatory work, an agreement is solely binding upon the parties and not effective against the bankruptcy estate as a third party.⁹⁵

Given the fact that the estate is considered as a “new” third party, it is thus not possible to include such party into a direct agreement. Conversely, invoking anticipated breach is held to be effective prior to the bankruptcy given that there is no real “creditor collective” requiring protection at this point of time. Apparently, invoking step in rights prior to the bankruptcy is efficient. This also explains why the rules providing for the recapture of assets where the transfer is qualified as preferential, because the transaction prejudices other creditors, (“återvinningsregler”) are not applicable with regard to cancellation of contracts. Apparently, prior to the bankruptcy, cancellation may not be considered as unjustifiable to other creditors and hence not subjected to the rules of recapture.⁹⁶

The Swedish preparatory work does not take position in this regard. It is held that whether the estate’s right to entry is to be considered as mandatory or discretionary is far too controversial and extended to several legal areas hence; the answer can not be given in a proposition solely considering the Goods of Sale Act. References are made to the Bankruptcy Act however without explaining how these rules shall apply.⁹⁷ Hence, the contemporary legal situation is fluid.

⁹³ Konkurslagen 1:1 § st. 2.

⁹⁴ Möller, 1988, p. 59 ff.

⁹⁵ NOU 1972:20 p. 310 f.

⁹⁶ See Håstad, Den nya Köprätten, p. 404, Tuula, p. 22.

⁹⁷ Prop 1988/89:76 p. 232 f, See as well Hellner, Speciell avtalsrätt II:2 p. 90, Insolvensrättsligt forum 22-23 januari 1990, p. 169 ff.

6. Conclusion

In conclusion, the principal rule in analogy with section 63 of SGA, stating that the debtor's estate is entitled to compel the solvent party to performance, is likely to apply with regard to the contractual relationship between the project company and the project company in course of the latter's bankruptcy. However exceptions may be acknowledge according to section 62 of SGA and the general principle of anticipatory breach due to the costly and long durable contract. The debtor's estate can not assure appropriate economical and personal requirements during the fully contracted period and hence there will be a fundamental breach of contract, because the estate lacks preconditions to perform contractually. The solvency of the project company is thus likely to comprise an essential precondition for the due performance and hence its insolvency, *per se*, constitutes an anticipated breach.

However, application of anticipatory breach is subjected to a number of uncertain factors and hence the risk of entry is impending. The solvent party may be deprived of its contractual right to cancel as a consequence of the estate's right to provide security, and thereby preventing the lenders from exercising their step in right as well.

The likelihood for the lenders to invoke their right to step in, directly against the debtor's estate is subjected to uncertainty as well. The legal situation is fluid and hence in accordance with the conclusion made in the Norwegian law proposal, it can not be excluded that the project company's bankrupt estate is entitled a mandatory right to enter into the project company's contracts.

7. Balancing of interests

The legal situation may not be predicted accurately without an adequate balance of interests. Hellner emphasises that it is not sufficient to hang on to the contractual or bankruptcy perspective, thus, pros and cons must be inventoried.⁹⁸ Möller concludes that above it all it is a matter of balancing the interest of the solvent party in protection and the interest of the bankruptcy estate, viz. the other creditors. Apparently, even though the "contractual" or the "bankruptcy" perspective is upheld, *de lege lata* acknowledge reason to be made to the different, and to some extent conflicting, interests come into play when the solvent public

⁹⁸ Hellner, Speciell kontraktsrätt, II:2, p.89-90.

party want to cancel, or the lenders wish to exercise their right to step in, and the project company's bankrupt's estate wishes to continue the contract.⁹⁹ This balance of interest also comprises the basis for the law reform presented below. Albeit this essay to some extent deliberates the right of the public party to independently cancel the lenders ability to step in, the primary objective is to examine the right of the solvent party to cancel when such step in right occurs, hence the efficiency of direct agreements. The two theoretical starting points of the examination of the efficiency of direct agreements presented previously, are here merged into a general analysis. Hence, whether the solvent party should be entitled to cancel, and whether the lender's step in rights are efficient directly against the bankrupt estate, is examined as one within this context. In addition, it is important to note that a law reform must consider these aspects as well.

7.1 The interest of the solvent party as opposed to the estate

The debate in legal literature predominantly deliberates the interests of the two perspectives of the solvent party as opposed the debtor's estate. The rules regarding the estate right of entry is comparable with the rules providing for the recapture of assets where the transfer is qualified as preferential. Hence, the objective is to protect the creditors from the risk that is likely to emerge in course of the debtor's insolvency and bankruptcy. So far, advocators of the contractual as well as the bankruptcy perspective are of the same opinion. However, the extent and the legal technique of such creditor protection are in contention.

The contractual perspective suggests the starting point to be that the creditors should be given protection from the debtor's contracting party wanting to get rid of contracts that are onerous on the basis that the solvent party would be unjustifiable preferred ahead of other creditors if he would be entitled to cancel such contracts.¹⁰⁰

Möller concludes that the effects of the of the rules on the treatment of the contracts in bankruptcy should be such that the interest of the bankruptcy estate in being able to fulfil the debtor's contracts for a favourable liquidation of the business should be satisfied as far as possible. However, without the solvent party's incurring a not inconsiderable further damage

⁹⁹ Möller, 1988, p. 39 ff.

¹⁰⁰ Hellner, Speciell avtalsrätt II:2, p. 83 and Tuula, p. 22.

or inconvenience beyond what he would have suffered if the contracts had instead been cancelled on the day of the bankruptcy judgement.¹⁰¹

Unsurprisingly, Möller's conclusion, representing the general "bankruptcy perspective", implies that the interest of the creditor as a whole is generally held to prevail over the interest of the solvent party in protection.¹⁰² The key arguments invoked in this regard is based on the risk, held to be likely, for the solvent party and the debtor, at the time for their agreement, to not consider interest of other creditors in the course of bankruptcy and hence for clauses to be contracted in a way that prejudice other creditors.

Furthermore, the interest of the estate is held to outweigh the interest of the solvent party because the latter is generally held not to incur particular inconveniences due to the entry. This is based on the fact that the solvent party generally does not have any other option. In the debate relating to construction contracts, Möller stresses that the client generally encounters inconveniences in finding a substitute to complete the construction work in any case and concludes that entitling the estate to enter is even advantageous for the solvent party. Besides, given the fact that the debtor's estate is not obliged to fulfil the solvent party's obligations, Möller argues that the entry comprises the better solution for the solvent party, who would otherwise had been satisfied with a contractual breach and a claim against the bankruptcy estate. It is thus, according to Möller reasonable to apply the general "free principle" that have crystallised in bankruptcy with regard to security, on contracts as well. Parties' obligations and rights should freeze to what have fall due on the day of the bankruptcy judgement and hence future claims can not be considered. Möller derives this conclusion from applicable provisions on the ladder of priorities that creditors are paid according to ensuing from the 11 chapter in the Bankruptcy Act and the Reorganisation Act (utdelnings- och förmånsrättsregler).¹⁰³

The interest of the estate is clearly expressed in the 7 chapter of the Bankruptcy Act. According to its section 8 the administrator is obliged to consider the creditors collectively right. The interest of the estate should thus be protected in order to achieve the best result for

¹⁰¹ Möller, 1988, p 842.

¹⁰² See for instance Möller 1988, p. 39 ff , Tuula p. 21, Hellner II:2, p. 81 ff, and Hästad, Sakrätt, p. 398 ff.

¹⁰³ Möller, 1988, p. 76

the company's creditors as a whole. Additionally, the administrator is obliged to act in order to achieve an advantageous and efficient liquidation.¹⁰⁴

The questions to be examined here are thus the particular interests and risks that are at stake in private public partnership and whether the objectives and arguments invoked in favour of the bankruptcy perspective, and expressed in the Bankruptcy Act 7:8, can be achieved by entitling the estate to enter into the project company's contract, and more specifically, the project contract.

7.2 Interest of the creditors as a whole

The theoretical starting point with regard to project finance and PPP is thus that the project contract amount to certain value for the estate. There are a number of aspects speaking in favour of the protection of the estate and its creditors. Given the project company's limited assets, the project contract basically amount to the whole value of the bankruptcy estate and hence what is left for the creditors in a liquidation. However, on the day of the bankruptcy, the project contract will be subjected to the freeze principle and hence become rather valueless. The objective of entry would thus be for the estate to complete the project and thereby being entitled the whole compensation sum from the public client, that is payable after completed work. Besides, the bankrupt estate has the opportunity to sell the project.

It is clear that cancellation may deprive the debtor and the creditors of this profitable contract producing a gain for the estate. The interest of the creditor's as a whole and an advantageous and efficient liquidation is certainly infringed if the bankruptcy estate is prevented from entry.

However, the first point to be made is who "all these creditors" are that the liquidator is obliged to act in favour of and that is held to outweigh the interest of the solvent party. Whether an agreement that infringes the right of the estate to accede to the debtor's contract is efficient is solely examined from the solvent party perspective. Apparently, the rules regarding the estate's right of entry predominantly refers to cases where the solvent party amounts to a bare minimum of all the creditors. However, in this regard, cancellation of the solvent party entitles the syndicated lenders to step in and hence incorporate the major part of the creditors.

¹⁰⁴ Konkurslagen 7:8 §

The efficiency of an agreement that includes other creditors beyond the solvent party wishing to cancel is thus not deliberated in doctrine. However, in the debate relating to construction contracts and the client's bankruptcy, Möller comment very briefly on clauses that entitle banks to assume construction contracts and complete the work, where the work is not completed accurately. He implies that banks solely are entitled to invoke such clauses where the estate wishes not to accede and hence where the contract is cancelled. This is based on the fact that the estate has the entire disposal of the debtor's assets, provided that the debtor is in possession of the property. Hence, it is held that the lenders may not prevent the estate from selling the building at the day of the bankruptcy. However Möller stress the lenders may buy the property from the estate. Besides, given the fact that the lenders have security over the property, the lenders may prevent the bankruptcy estate from selling the uncompleted building according to the "Utsökningsbalk" chapter 12.¹⁰⁵ Möller does not comment upon such clauses in case of the entrepreneur's bankruptcy.

7.2.1 The principle of equality

Albeit the right of the solvent party to cancel comes into another light given the lenders' step in rights, the provision in the Bankruptcy Act stating that the liquidator must act in favour of "all the lenders" is nevertheless violated. Hence, if the lenders were entitled to step in they would be preferred ahead of other creditors. Unlike the English system of administrative receiver that still apply with regard to project finance, creditor's may not, according to Swedish law, decide upon the enforcement remedy and run the business solely in favour of the secured creditors. In Sweden the principle of equality prevails and hence all the creditors are treated equal. Apparently the principle of freedom of contract is here outweighed of the principle of equality.

Contemporary literature does not distinguish between creditors and do not specify the actual meaning of the "creditor collective".¹⁰⁶ The wording in doctrine solely draw attention to "all the creditors" without distinguishing between different grade of protection among creditors, hence, the principle of equality can be said to be taken as a form of "silent" point of departure. Martinsson indicates the risks induced making use of such a language. However, he predominantly refers to the principle of freedom of contracts in this regard and advocates the

¹⁰⁵ Möller, 1988, p. 283.

¹⁰⁶ See for instance Möller, 1988, p. 75.

importance of openness and that principles may be overvalued and marginalise other important interests.¹⁰⁷

“Partly as a result of the unarticulated and rudimentary argumentation, certain interests are overvalued. One such interest, the freedom of contract, is often taken as a point of departure for the analysis and various factors straighten this tendency. Three such factors worthy of mention are the following: the parties to the agreement are the ones that provide the elements of the contractual construction; a belief in the existence of regulatory competition between different legal systems, and, the use of terminology, where classifications in main rules and exceptions, marginalizes important interest.”¹⁰⁸

However with regard to project finance and public private partnership the principle taken as a point of departure is rather the principle of equality. In this regard it may be questioned why such principle should be upheld and prevail over the principle of freedom of contracts. It is often said that the most fundamental principle of bankruptcy is the *pari passu* or pro rata payment of creditors, the interest of equality is upheld by such principle however consideration is nevertheless made to the proportion of each of the creditor’s debt.¹⁰⁹

7.2.2 Interest of protection of different creditors

Thus, who are all the creditors involved in project finance and what constitutes their interest of protection?

The concept of private public partnerships as well as the financing techniques may vary. However, the most commonly used technique and primarily referred to here is the “Build Operate Transfer” model (“BOT”). This is the technique used in Norway and is here called OPS (“Offentligt Privat Samarbete”).¹¹⁰ BOT projects are defined by Uncitral as projects where the contracting public party selects a private sector party “to finance and construct an infrastructure facility or system and gives the entity the right to operate it commercially for a certain period, at the end of which the facility is transferred to the contracting authority”.¹¹¹

¹⁰⁷ Martinsson, Claes, Kreditsäkerhet i fakturafordringar, 2002.

¹⁰⁸ Martinsson, Kreditsäkerhet i fakturafordringar, 2002.

¹⁰⁹ See for instance Wood, Principles of insolvency, 1996, p. 10.

¹¹⁰ Närings- og handelsdepartementet & KPMG AS, p. 17.

¹¹¹ Uncitral, United Nations, 2001, p. 5.

According to the model used in Norway, the project company is entitled to receive payment from the Norwegian Public Roads Administration. However, no payments are received before the road sections are opened and available for traffic. The payments are hereafter made in terms and provided that certain requirements are met such as quality, availability, safety and environment etc. Apparently, the public party reduces its risks in that the private sector is not entitled to receive any payments until the road construction is completed. The project company is thus not only retaining all the responsibility for the financing (and the construction, operating and maintenance) of the project however assumes the major risks associated with the project as well.

7.2.2.1 Interest of the project sponsors and the senior lenders

Hence, the interest of protection for the project sponsors and the project company appears to be prominent. However, large scale infrastructure projects are often highly leveraged which means that the projects are predominantly and sometimes exclusively financed by debt capital.¹¹² Hence, the share capital provided by the project sponsors solely amount to a bare minimum compared to the debt capital raised by the syndicated lenders. Besides, the risks for the project sponsors are already reduced by so called single purpose vehicles (SPV), that are generally used, companies solely established for the purpose of carrying out the project in question. This is generally described as non-recourse or limited-recourse techniques. Given such technique, the project creditors may only rely on the assets held by the project company and thus cannot take recourse to the assets held by the individual project sponsors.

Furthermore, as emphasised previously, the assets that are held by the project company are often very limited and uncertain. Hence, the creditors base their financing decisions almost exclusively on the expected future revenues of the project in question. Besides, BOT-projects are usually very capital-intensive and therefore require large amounts of financing.¹¹³ Apparently the risk induced in financing large infrastructure projects is exceptionally high and it is predominantly the syndicated lenders that are exposed to such risk.

7.2.2.2 The interest of other unsecured creditors

What about the other unsecured creditors? Given the fact that the lenders seeks to take security over as much assets as legally possible, there are reasons to consider the interest of

¹¹² Merna & Cyrus, Financing and managing of infrastructure projects, p. 98.

¹¹³ Merna & Cyrus, Financing and managing of infrastructure projects, p. 98.

protection of unsecured creditors. The primary purpose of the lenders security is thus defensive, to act as “a shield not a sword”.¹¹⁴ By taking security, the secured creditors limit the possibility of the unsecured creditors interfering in the relationship between the project debtor and the secured creditors.¹¹⁵ The taking of security also limits the risk for, and potential negative affects of, any attachments or enforcements that the unsecured creditors may pursue against the project company. Apparently, there is not much room of protection left out for unsecured creditors. However, the point is that given the particular SPV technique, there are few unsecured creditors to protect. The unsecured creditors worth mention in this regard are suppliers.

Nevertheless, the primary risks for the suppliers can be summarised to not get paid for outstanding debt, the bankruptcy of the project company or to be forced to performance where the prospects for the due performance of the project are dubious, as in case if the estate enter into their agreements or into the project agreement. Apparently, these aspects are already considered in direct agreements. In fact, third parties have already consent to deprive its right to cancel provided that the lenders step in and complete the project in question. In order to deprive the suppliers of their cancellation right the lenders have agreed to compensate them for all owing debts. It appears that the risks induced for the suppliers can not be compared with the risks the lenders are exposed to.

The primary basis behind the creditor’s acceptance of being deprived of their cancellation right, can be traced to the exceptionally high risks-exposure implied in project finance. The creditors are clearly aware of this reality and that it is primarily the syndicated lenders who are exposed such risk. More important however, entitling the lenders to step in definitely increases their own chances of obtaining anything, compared to the unfavourable outcome of a bankruptcy proceeding, with or without entitling the estate to complete the project.

7.2.3 The objective of a favourable liquidation

Given the reduced asset of the project company, a bankruptcy proceeding will hardly suffice to even compensate secured creditors. All the other creditors, except for the syndicated lenders, are thus unsecured or subordinated lenders and hence the outcome of a bankruptcy proceeding is unlikely to be with any prospects of success for “all the creditors”.

¹¹⁴ Wood, Project Finance, p. 30.

¹¹⁵ Vinter, Project Finance, 1998, p. 149.

The result would not be different if the debtor's estate were entitled to entry into the project contracts, most likely the contrary. The first point to be made here is that the hypothetical options available for the estate related to the right of entry as portrayed previously, are somehow nothing but theoretical. As indicated above (under the chapter economical aspects and long-term agreements) the entry of the estate is subjected to a number of inconveniences. Depending on how far the project has gone, the estate is unlikely to complete the work prior to the predicted bankruptcy estate. The entire duration of these projects is proximately 20 years, hence, the estate may never accomplish the operating and maintenance periods. Given that the estate lacks resources and skills to complete the project on its own, it is generally obliged to sell the project. Apparently, assignment is nevertheless compulsory and hence the estate will encounter problems in obtaining necessary consents from third parties. Most important however, since there is no established market for infrastructure facilities such as roads and railways etc. the price paid in liquidation by selling the project as a "going concern" would almost certainly not generate much income. The alternative to entitle the lender's to step in and complete the project provides a better solution in several aspects.

Apparently, the objective of a financially advantageous liquidation of debtor's business in favour of all the creditors is unlikely be achieved by entitling the estate to enter into the project agreement. On the contrary, all the creditors fear such entry; hence, being compelled to performance without any prospect of success for the continuation of the debtor's business, or the outcome of a combined sale, exposes them to an exceptionally high risk.

7.2.4 Deficit of incitement for the debtor to protect its creditors

Hence, avoiding bankruptcy as far as possible is definitely a common interest of all the creditors. The question is thus how bankruptcy can be prevented. This deliberates the key argument of the lacking insensitive for the debtor to consider all the creditors in case of bankruptcy.

Again, this must be traced back to the particular risks induced in project finance. The solvency of the project company is thus dependent on the future payments from the client, the public counterparty. Both the equity holders and the creditors focus their attention on the prospective future revenues of the project company. Careful evaluations are thus made before a project is implemented, in order to guarantee that the project will generate sufficient return

during its lifetime to service the debt and repay the equity with a return that is suitable to the risks that the equity holders are exposed to. To put it straight, everything that impedes the project from continuing according to contracted terms comprises key threats for all creditors. Particular delays and other uncertain factors are thus considered as potential threats.

A contracting party wanting to cancel its contractual obligations definitely comprises an outstanding potential threat that might lead to chain effects and inconvenience in finding a substitute. Accordingly, the short-term interest of one party is in conflict with the long-term interest of the due performance of the project. When a single party lack incentives to act in a way that appears to be favourable for the entity, can in economical theory terms be described as a market failure and hence require to be corrected somehow. Apparently, this is the whole basis behind the debate of right of the debtor's estate to enter into the debtor's contract. The market failure or the interest of the estate and the creditor as a whole is to be upheld by mandatory provisions. However, in this regard, the parties have corrected the market failure themselves in direct agreements as well in other contractual work.

As stressed previously, all the creditors are aware of the exceptionally risks induced in project finance the inconveniences encountered in case of bankruptcy. Apparently, all these aspects are taken into account and carefully negotiated with the objective to allocate the risks to the parties who are best equipped to manage them. The contracted documentation is thus very extensive and every individual contract can be described as a part of an entire net, hence the efficiency of the entirety is depended on each single agreement. This may be illustrated by the fact that a single change in a particular contract generally requires changes in a number of contracts.

Direct agreements can be said to comprise part of the core of this net of contracts in that its primary function is to safeguard the objective for all creditors, hence to keep the project alive. Without such cautious assessment, banks would not be willing to provide funds for large infrastructure projects. In order to finance such projects they must be what is generally described as "bankable". Nevertheless, high risk would increase the price of the lending, a cost that in the end would be borne by the client hence the public. The efficiency of direct agreements is thus a precondition for the project to become bankable. Besides the other creditors are liberated from the key financial risks and have so agreed upon entitling the lenders step in rights, hence a reasonable price to pay. Contracting parties such as suppliers

etc. that have entered into direct agreements and thereby consent to deprive its contractual cancellation rights are besides compensated by the lenders in that they guarantee all owing debts.

Apparently, entitling the lenders to step in definitely comprises the better solution for “all the creditors” compared to what they would have obtained as un-preferred creditors in a winding up proceeding or succeeding the liquidator’s entry into affected contracts.

Albeit the key objective for the lenders to negotiate step in rights are to safeguard their own interests, this appears to be the most convenient solution for all the parties’ involved.

Apparently the interest of preserving the principle of freedom of contracts appears to be essential. Besides, the key argument invoked in favour of the bankruptcy perspective, stating that there are no incentives for the debtor to consider other creditors, proves to be poor with regard to project finance. Indeed, the factual presence of direct agreements renders the argumentation inadequate. Direct agreements can be described as a form of “private work out” and hence certainly take the interest of other creditors into account.

Given the fact that the creditors have agreed upon a common solution that appears to be the most convenient, it may definitely be questioned who “all the creditors” are that requires mandatory protection. Hellner supports the argumentation here invoked and advocates that the conflict of interests can be complicated and that general conclusions can not be upheld, such as that the debtor, when he enters into agreements, has no interest of protecting his creditors in case of bankruptcy.¹¹⁶

Apparently, a balancing of the interest of protection between the different creditors certainly speaks in favour of at least to some extent give preference to secured lenders as opposed to other creditors. However, direct agreements may be negotiated in different ways and hence solely provided that the agreements prove to be reasonably, such conclusion prevails.

7.3 The Interest of the public and the solvent party

The final key argument referred to above, in favour of the interest of the estate and its creditors to prevail over the interest of the solvent party due to that the latter is generally held to not incur any inconsiderable inconveniences from the entry of the estate, is to be examined

¹¹⁶ Hellner, Speciell avtalsrätt II:2, p. 83.

as well. With regard to project finance in general and private public partnership in particular, the solvent party is not solely a contracting party however, constitutes a public interest. Hence, the interest of the solvent party is equivalent to the public interest of obtaining infrastructure.

Albeit the obligation of the project company may not be classified as personal according to the traditional meaning of personal attribute, it is nevertheless essential for the public counterparty that its contractual right to cancel in case of the project company's bankruptcy remains efficient.

7.3.1 Economical risks

As indicated previously, the public counterparty has reduced its risk in that the payments are made subsequent to the completion of the project, however, the risks are far from eliminated. Besides, the step in rights for the lenders is solely a right and hence failure of the project company often results in that the public counterparty is obliged to take over the project and the economical burdens as well.¹¹⁷

The bankrupt estate is unlikely to perform contractually, particularly due to the extended and costly project. Proper performance is depended on subcontracting parties. The estate is generally entitled to enter into these contracts as well, however, subcontractors may in analogy with the 63 section of SAG claim security that the estate may not be able to provide. The estate may thus be forced to find new contracting parties such as constructors and suppliers and hence the argument invoked in favour of the bankruptcy perspective, claiming that the same contracting parties may be employed, is not compelling. New constants must be obtained from individual or from all contracting parties, following an assignment of the whole project company. Besides, the consequences for the solvent party is generally emphasised in legal literature, where the bankrupt estate first, for the period of the bankruptcy, enter into the project contract itself and solely employ third parties, and thereafter accomplish an assignment. Möller stress that in cases where the duration of the performance goes beyond the time for the bankruptcy, it is doubtful if the solvent party should be compelled to performance, the client should not be required to accept two assignments of the contracts, first the entry of the estate and secondly a new counterparty subsequent to the bankruptcy.¹¹⁸

¹¹⁷ See for instance Standardisation of PFI Contracts, Version 3, HM Treasury, April 2004, p. 133 ff.

¹¹⁸ Möller, 1988 p. 292.

Besides the risk that key personal will leave due to the bankruptcy render the performance uncertain. Apparently, due performance can not be assured, risk for delay is outstanding and hence the price payable for the public will amount to a significantly higher amount than if the solvent party would be entitled to cancel on the day of the bankruptcy.

7.3.2 Quality risks

Most important, entitling the bankrupt to complete the project does not solely imposes economical however quality risk as well. The solvent public party is responsible for the quality of the public facility in terms of function, security, environment, etc. New contracting parties may not guarantee contracted quality. If the facility in question concerns the construction of a road for instance, quality such as the security for the road-users, accessibility and environmental concerns may not be met.

The duration of the project is vital in this regard. The quality of the public facility must be granted not solely during the construction phase however after the project is completed and opened up for the public. Given the fact that the administrator is obliged to act in order to achieve a favourable and efficient liquidation in favour of all creditors, the factual interest of the infrastructure project in question is likely to be ignored. The administrator is not in any case obliged to consider the long-term objectives of the public facility. Hence there is no incitement for the estate to grant quality during the operation and maintenance period. Albeit the estate is to assign the whole project it is not clear whether the new party may guarantee the long-term conditions. The estate has thus no interest, obligation or incitements to protect the quality of the performance succeeding the duration of the bankruptcy. The administrator may even violate his obligations according to the 7 chapter 8 section of the Bankruptcy Act, if these aspects are taken into consideration since the performance may be more expensive and long-lasting.

The impending risk of the bankruptcy estate not to perform contractually was held to be one of the key factors behind the legislative law reform in Norway, particularly due to the public interest of infrastructure.¹¹⁹

¹¹⁹ Vedlegg 201205, p. 6.

7.4 The interest of company rehabilitation

Albeit the outcome of a balancing of interests appears to be clear and hence speaks in favour of depriving the estate of its right of entry, uncertainty *de lege lata* prevails. However, the most contemporary prominent threat to the validity of such balancing, is the interest of rescuing companies as going concerns. At first sight considering such interest appears to have no bearing on project finance, particularly due to the non-resource finance technique. The project company solely comprises a shell and is thus unlikely to be subjected to rehabilitation proceedings.

However, given the increased attention and preference in favour of rehabilitation process in the insolvency debate all over Europe, it is crucial to take these aspects into consideration as well. Nevertheless, the trend demonstrated in Europe definitely indicates an increased willingness to weaken the superiority of secured creditors. Since step in rights give preference to secured lenders it is most likely that legislators regard such rights with hostility. In many countries in Europe, particularly demonstrated in our Nordic neighbour countries, the two proceedings of bankruptcy and company reorganisation are now integrated. A consequence of such merge is that the rules of the estate's right to enter have become mandatory with exception for certain contractual relationships as described above.¹²⁰ The Swedish Company Rehabilitation Act (CRA) Chapter 2 section 20, already lays down mandatory provisions of the right of the estate to enter into the debtor's contract.

As mentioned previously, the Swedish law proposal considering the debtor's agreements in insolvency have not been implemented due to the coming proposal of incorporating the two proceedings. The need is firmly expressed in contemporary literature and various proposals on how such legislative act could be formulated are presented. As a step in the direction towards an integrated insolvency procedure, the Committee presented a proposal regarding general rules governing the bankrupt's estate's accession to the debtor's agreement, largely in accord with the rules proposed for company reorganisation.¹²¹ Apparently, it is just a matter of time before a legislative reform will be implemented and hence an examination without considering these aspects is moderately a waste of time.

¹²⁰ SOU 2001:80 p. 25.

¹²¹ SOU 2001:80 p. 26.

7.4.1 The objective of improving business

The driving force behind the extended focus on company rehabilitation in Sweden thus correspond to the debate in the Nordic Countries as well as the wording behind the new security regime in England (and Wales) that abolished the right of a qualifying charge holder to appoint an administrative receiver. In UK, clearing banks have been considered to be too quick to enforce their security and break up business which might have survived as going concerns. Administrative receivership was perceived as almost an instrument of repression not just of failing companies, but also of their unsecured trade creditors. With every company whose asset were broken up and sold by the bank's receivers, so another outlet for that company's erstwhile suppliers failed. In this way the financial collapse of yet further companies was made more likely.¹²²

Albeit, the Swedish security law has not been weighted as heavily in favour of secured creditors as in England, the same arguments prevail. The process started with the New Right of Priority Rules where floating charges were converted into a general right of priority and that security should cover one half of the value of all the debtor's property.¹²³ During the course of its work the Committee was issued with supplementary terms of references to investigate whether, during a company reorganisation, the debtor should be entitled to terminate agreements prematurely. In conjunction therewith, certain other issues concerning the debtor's agreement in company reorganisation proceedings were investigated and the need for clarification and amendments was expressed. Besides the need to incorporate into the Bankruptcy Act general rules regarding termination and performance of the debtor's agreements by means of the estate's accession thereto was stressed, corresponding to the rules to apply in the event of company reorganisation.¹²⁴

The primary objective of the New Right of Priority Rules and the essence of the debate in Europe is thus to improve the environment of business, predominantly with regard to small enterprises. Hence, the possibility for healthy business to rehabilitate is to be improved and the number of bankruptcy proceedings reduced. Besides, the interest of enterprise is considered by strengthen unsecured creditor's, such as suppliers, priority rights in the event of Bankruptcy.

¹²² These thoughts were presented by the Labour Party in Opposition during the recession in UK in the early 1990.

¹²³ SOU 1999:1.

¹²⁴ SOU 2001:80 p. 25.

In conjunction with the reform in England the interest of banks to take a more expansive and long-term view was articulated as well. Some commentators expressed far-reaching reforms with the belief of achieving an effective point of leverage in order to produce a market dynamic toward more long-term lending.¹²⁵ Will Hutton stress that privileging banks in insolvency proceedings encourages short-term credit. Instead of relying on a favourable legal system banks should according to Hutton do the “legwork” them selves, if they want to lend money safely. Downgrading banks legal importance in insolvency proceedings would encourage them to evaluate business, requiring better business plans and financial skills from their customer base, instead of evaluating business in terms of property, Hutton continues.¹²⁶

However, the quandary of promoting the environment of business is highly complex and controversial. The New Right of Priority Rules have been subjected to vast critic from interests of enterprises as well represents from banks, claiming that the reform will generate higher price of lending and thus make it harder for (small) enterprises to obtain capital. Hence, the new rules are held to rather counteract the objective of improving the conditions of business since the availability of capital is considered to be the most essential factor in order to promote business, definitely more crucial than the ranking of priority in bankruptcy.

7.4.2 The American Chapter 11 proceeding and *de lege ferenda*

Some authors in Swedish as well as in English literature suggest the American Bankruptcy Code to serve as a model.¹²⁷ The insolvency proceedings are here integrated into one single Act and the rules for each proceeding correspond to a large extent, Chapter 11 lays down rules on company rehabilitation and chapter 7 refers to bankruptcy. The US model goes further than the Norwegian and Danish insolvency rules in that the solvent party is automatically deprived its right to cancel as soon as a proceeding has commenced.

Section 365 (e) of the Bankruptcy Act nullifies default clauses which permit the other party to terminate on the insolvency of the debtor. The section provides that, albeit a provision in an executory contract (or unexpired lease or in applicable law), an executory contract (or unexpired lease) of the debtor may not be terminated or modified at any time after the commencement of the case solely because of the insolvency or financial condition of the

¹²⁵ the Labour Party in Opposition during the recession in UK in the early 1990.

¹²⁶ Hutton, Will, *the State to Come*, 1997, p. 72.

¹²⁷ See for instance Tuula p. 178 and Will Hutton.

debtor, or the commencement of the case or the appointment of a trustee, i.e. standard contractual events of default which spark off on insolvency and the institution of insolvency proceeding are nullified.¹²⁸

It appears that step in rights goes hereunder and hence is nullified under US insolvency law. Step in rights are not commented in American project finance literature and not commonly used.¹²⁹ However, the project deliberated for the purpose of this essay originates from Europe and hence English law is generally selected to apply.

A contract that contains a provision permitting the counterparty to cancel on insolvency is internationally recognised as *ipso facto* clauses. Bankruptcy legislation that nullifies *ipso facto* clauses such as the US model is in an international perspective uncommon. There are few countries that expressly nullify such clauses, mention can primarily be made to France, Canada and New Zealand.¹³⁰ However, because of the savage effect upon contracts of the statutory freeze, certain exceptions have been carved out by the American bankruptcy code.¹³¹

The law reform in England did not go as far as such “debtor-in-possession”, court-supervised company rehabilitation system as in US. However, the debate in Swedish literature points at this direction. It must be emphasis that there is a vast danger induced in solely implementing a procedure ensuing from a completely different law tradition into Swedish law. As stressed previously, promoting business is highly complex and there are a number of aspects to consider. The law of insolvency must be seen in conjunction with other law provisions that lays down rules for companies, particular attention must be made to the Company Act.

US do not have a homogenous legal culture and applicable (insolvency) law indicates “pro-debtor” as well as “pro-creditor” attitudes. Wood stress there is an acute conflict between these attitudes.¹³² Without making any judgements of the US insolvency law it must however be stressed that a legal system can be described as a form of balance where for instance a pro-debtor Company Reorganisation and Bankruptcy Act can be balanced by a more pro-creditor Company Act. The most essential rules in order to prevent insolvency proceedings in US can

¹²⁸ Section 365 (e) of the Insolvency Act 1986.

¹²⁹ Interview with Denis Petkovic, practitioner at Chadbourne & Parke, London.

¹³⁰ Wood, Principles of International Insolvency, 1996, p. 65-68.

¹³¹ Exceptions are made for personal contracts for instance, see section 365, see as well Wood, Principles of International Insolvency p. 68.

¹³² Wood, Principles of International Insolvency, 1996, p. 8

rather be said to be found in the Company Act. The US Company Act stipulates responsibility for the insolvency of a company, of other persons than the company such as directors and officers, to spark off at a considerably earlier stage than in Swedish law. Thus, the environment of business can only be improved by balancing different law provisions and it may be questioned whether the most efficient way of improving business can be achieved by mandatory rules on the treatment of the bankrupt's contract. There may be reasons to at least complement such law with rules aiming to create insensitivity for business, such as endorsing company directors to take proper responsibility for their business at an early stage for instance.

It is not my purpose to examine this further however solely point out that there are reasons to consider the whole legal context in the debate of the treatment of debtors' contract in insolvency and the interest of company rehabilitation. Given that a model works out in one country does not necessarily mean that it proves successful in another, particularly because of deviating principles prescribed in different jurisdictions' Company Acts.

Besides, the objective of this essay is to examine the rules on insolvency with regard to project finance and hence the wording of general applicable rules is left out as well. Nevertheless, these aspects indicate that the choice between a "debtor-in-possession", court-supervised company rehabilitation system and a system encouraging private work out initiatives giving credence to the principle of freedom of contract is far from evident. Besides, with regard to the rules on the bankrupt's contracts, it is clear that different contracts require different solutions, hence a factor that must be weighed against the interest of legal certainty and the objective of consistency.

7.4.3 The objective of company rehabilitation and project finance

However, against the background presented above, considering project finance, there are certain factors speaking in favour of giving preference to the principle of freedom of contract. The interests and objectives uttered in the debate of company rehabilitation are most likely to be achieved by entitling the lenders to step in and hence give effect to the parties' contracted "private work out".

General mandatory provisions can not consider the particular interests and risks that come into play with regard to project finance. The parties involved fear a court supervised process

where the liquidator enter into the project contract thus such formal process comprises one of the most fundamental threat to the expected cash flow. A statutory freeze has savage effects upon contracts and may prejudice creditor protections, besides a public declaration of insolvency generally devastates business. Furthermore, the entry of the estate and a formal proceeding is costly and considerably less flexible than a transfer carried out by the lenders. The advantages generally recognised with formal proceedings such as the power to bind dissentient creditors and that formal proceedings are a statutory freeze on individual creditor enforcement, have no validity in this regard since the creditors are already bound according to the terms in the direct agreements.¹³³

The objective of step in rights is accurately identical with those prescribed for company rehabilitation. The primary objective is to rescue the project company when it encounters insolvency problems. Banks are cautious before they chose to exercise their most far-reaching step in right thus such entry is connected to fundamental responsibilities and risks. There are a number of generally recognised risks such as environmental risks. Besides Swedish law, particularly the Swedish Company Act may prescribe certain liability not yet subjected to examination. Entry effectively means “management power” and hence certain legal responsibility is likely to apply. Whether the Common Law concept of “shadow directors” is applicable in this regard has not been subjected to scrutiny in English Case law nor commented in literature however there are reasons to investigate such responsibility further. Besides, there are reasons to examine whether the transfer to a new entity, which is generally held to reduce the responsibility of banks, under Swedish law, may be considered to comprise a combine relationship (koncernförhållande) and hence bring about extended responsibilities and obligations according to the Swedish Company Act. Furthermore, rules against “self-dealing”, i.e. a mortgagee selling the mortgaged asset to himself or to a person connected with him are applicable.¹³⁴ The Swedish rule of “förverkande av pant”, *lex commissoria* according to the 37 § of Law of Contracts and 10:2 Commercial Act (“Handelsbalken”)¹³⁵, must be considered as well.

¹³³ Wood, Principles of International Insolvency, 1996, p. 174.

¹³⁴ The rule is basically intended to protect against mortgaged assets being sold at an undervalue and thereby constituting unfair foreclosure. The English rule does not appear to be an absolute one but the mortgagee will have to prove that the consideration for the transfer of the asset to the connected person was (essentially) a fair one: See Tse Kwong Lam v. Wong Chit Sen and others (1983) BCLC 88.

¹³⁵ Lag(1936) om pantsättning av lös egendom som innehas av tredje man.

Nevertheless, the clauses in direct agreements should be contracted in a manner that gives the project company a real chance to rehabilitate. If there are no prospects of success for the project company to complete the project, the objective of a direct agreement is thus to keep the project alive, hence the business affected by bankruptcy shall survive and transferred to a new owner. Given that such transfer is anticipated and the contracting parties prematurely agreed to consent, the prospects of success is noticeably more likely than if the bankrupt estate were to accomplish a transfer.

There is no interest of protection of a single purpose vehicle, an empty shell company without own employers and where the project sponsors have attained a reduced risk according to the non-resource finance technique. Keeping the project alive thus safeguards the solvency of subcontracting companies and the vast quantity of workers here employed, besides the chances for key persons to remain are made more likely. Furthermore, it is necessary to take the interest of the subcontractors and other claiming derivative rights from the project company into account as well. The failure of the head contractor or their immediate contractor may, by domino effect, precipitate their own insolvency.¹³⁶

It is clear that the target of the changes in the insolvency legislation brought about in the English Companies Act as well as the basis behind the legislative reforms in Sweden giving unsecured creditors increased priority in bankruptcy, chiefly where companies with significant unsecured creditors. The various examples given in the English official Explanatory Notes to the Act related to the different purposes of administration are service or manufacturing companies with trade creditors.¹³⁷ The political reasoning behind abolishing administrative receivership as a means of enforcement of security is far less cogent when there are no, insignificant or few unsecured creditors to protect. Hence, this is often the case in project finance where the borrowers usually are vehicle companies without significant unrelated unsecured creditors.

Apparently, long-term interests are certainly considered by entitling the lender to step in. It is rather clear that the public interest of infrastructure overrides the interest of protecting the particular insolvent project company, principally as the socio-economic cum labour market policy as well as other interests prescribed in favour of mandatory company rehabilitation

¹³⁶ Wood, *Principles of International Insolvency*, p. 60.

¹³⁷ See paragraphs 647 – 652 of the Explanatory Notes to the Enterprise Act 2002.

process is more likely to be achieved by entitling the lenders to take the responsibility to complete the project.

7.5 The early warning technique

In fact, mandatory rules of the estate's right of entry have proved to contravene the purpose of company rehabilitation. In order to avert the onerous outcome of an insolvency proceeding where the estate chooses to entry, and make the project bankable, banks incline to negotiate clauses that entitle them to step in at an early stage, before bankruptcy is to be likely.

7.5.1 Development in Finland

This is demonstrated in Finland where a new public private partnership has been awarded very recently, the E-18 Muurla-Lohja motorway. The project consists of the design, construction, maintenance and financing of a 50 kilometre motorway between Helsinki, the capital of Finland, and the coastal city Turku and the road is scheduled to be opened in 2009.¹³⁸ As in so many other countries, the developments have originated within the transportation sector. The first, and up to now only, public private partnership in Finland regarding road infrastructure, was an upgrading of a 70 kilometre road section between Järvenpää and Lahti called the "Highway Four Project". The project has been and still is considered as a great success. The use of the private finance technique advanced the implementation of the project with four to five years and shortened the construction time by one year.¹³⁹ Hence the success has paved the way for further public private partnership and the government has issued an extensive programme for further public private partnerships in the transportation sector.¹⁴⁰

However, the step in right clauses have for these particular projects been contracted with the intention to spark of at an early stage, a technique that has been called "early warning".¹⁴¹ The legal situation in Finland is equivalent to the Swedish. The bankruptcy Act contains no regulations regarding the estate's entitlement to demand performance of the debtor's agreement hence, legal uncertainty prevails. The Reorganisation Act on the other hand

¹³⁸ Pekka Lehtinen, Scandinavia: Public private partnerships for the development of infrastructure in Finland, published on the webpage www.chambersandpartners.com.

¹³⁹ See <http://www.nelostie.net/> and Näringsdepartementet, ALTERNATIV FINANSIERING GENOM PARTNERSKAP, Stockholm (DS 2000:65), 2000, p. 36.

¹⁴⁰ Näringsdepartementet, ALTERNATIV FINANSIERING GENOM PARTNERSKAP, Stockholm (DS 2000:65), 2000, p. 36.

¹⁴¹ Intervju Lisa Almen, EIB.

prescribes such right, in accordance with the Swedish rules.¹⁴² Albeit Finland seems to have embraced the concept of public private partnerships, the government has not yet gone as far as in Norway, where a legislative reform have been implemented considering the bankrupt estate's right to accede to the debtor's contracts, as described previously. As in Sweden the general rules are nonetheless subjected to investigation.¹⁴³

7.5.2 Risk for early cancellation

However, beyond the difficulties and extended negotiation induced in the early warning technique, such method give incitements for the lenders to exercise their step in rights before the project company has been given a proper chance to survive. The direct agreements contracted with regard to the E-18 project, entitles the lenders to exercise their step in rights even prior to the solvent party according to contracted terms is entitled to cancel, before the time for the project company to cure its default has expired.¹⁴⁴ Nevertheless a step in from the lenders proves to be a better solution than entitling the liquidator to complete the project, such entry is nevertheless connected to a number of risk and thus a threat for the due performance of the project. Besides in this regard, cancellation of the project contract is equivalent to insolvency for the project company since this is the sole source of income.

Apparently, mandatory rules and legal uncertainty considering the right of the bankrupt estate to compel performance of contracts, tends to result in techniques that counteract the objectives of company rehabilitation as well as bankruptcy.

Håstad supports this argumentation. He highlights the risk for the solvent party to cancel prior to the bankruptcy as soon as suspicion of the debtor's solvency appears, in order to get protection from the onerous outcome of an insolvency proceeding where the estate chooses to entry.¹⁴⁵ With regard to project finance such risk appears to be crucial and hence a balancing of interest may even from a "bankruptcy" perspective bring about exception from the general principle.

Besides it should be stressed that the early warning system may be subjected to the 36 § of the Swedish Law of Contracts. It may be considered as unreasonable to entitle the lenders to step

¹⁴² "Företagssaneringslagen" The Reorganisation Act, § 27 3 st. correspond to FRekL 2:20 §.

¹⁴³ See SOU 2001:80 p. 117 ff.

¹⁴⁴ Intervju Lisa Almén, EIB.

¹⁴⁵ Håstad, Sakrätt, p. 402.

in at such an early stage that the project company has not been given reasonable time to perform on its own.

8. Conclusion

It appears that the two perspectives deliberated in doctrine, the solvent party as opposed to the bankrupt estate and its creditors prove inadequate pertaining to project finance. There is considerably more interest to take into account that renders the traditional argumentation invoked in legal literature inapplicable for the particular circumstances at stake in project finance. The concept of “all creditors” must be modulated. The interest of protection noticeably varies among different creditors and hence there are reasons to give preference for the syndicated lenders who comprise the major part of the creditors and those subjected to the major risks.

None of the risks that hold to be likely in legal literature or key arguments invoked in favour of the bankruptcy perspective is pertinent considering project finance where the lenders have step in rights. There are incitements to consider other creditors in the contracting of the solvent party and the debtor prior to the bankruptcy. The solvent party does incur an inconsiderable further damage or inconvenience beyond what he would have suffered if the contracts instead had been cancelled on the day of the bankruptcy judgement. Besides this inconvenience is not a matter of concern solely for the single contracting party however encompasses the public interest of infrastructure and the quality of such. Besides the lender’s step in comprise a substitute providing a noticeably better solution. The most efficient and favourable solution for “all creditors” will be achieved by entitling the lender’s and hence not the estate to enter into the project company’s contracts, particularly the project agreement. It may certainly be questioned why the estate should be considered as a “new third party” not possible to include in direct agreements prior to a bankruptcy, when all major creditors participate in such agreement.

However, *de lege lata* as well as *de lege ferenda* remain uncertain. The principal rule *de lege lata* give preference to the right of entry for the estate in analogy with the 63 § SAG. Albeit exceptions can be made in analogy with anticipatory breach such deviations from the basic principle is subjected to inconveniences. The debate *de lege ferenda* indicates a highly trend towards company reorganisation and increased priority of secured creditors.

The objectives behind the new insolvency rules and the essence of the debate of incorporating the two insolvency proceedings are considerably more likely to be achieved if the lender's are entitled to enter into the debtor's contract. The commission advocates flexibility and the importance of giving all the creditors incentives to participate. It can be questioned if the best way to achieve such goals is through mandatory rules is. Conversely, the principle of freedom of contract and encouraging private work out insensitive, as provided for in direct agreements, is without doubt a better solution for the particular circumstances in project finance.

In conclusion, a balancing of interest, *de lege lata*, definitely points in favour of entitling the lender's to step in and the solvent party to cancel and hence not entitling the estate to accede to the debtor's contracts. However, uncertainty prevails. Besides, it is just a matter of time before a legal reform is brought into force, prescribing general rules in favour of the bankruptcy estate to enter. It is thus essential to carve out exceptions for project finance and public private partnership in such proposal. Against this background a law reform is here presented.

9. Law reform

9.1 Introduction to the proposal

The point of departure for a law reform is thus to carve out exceptions from the principal rule of the bankrupt estate's right to enter into the debtor's, hence the project company's agreements in relation to the particular circumstances here examined. However, there are a number of aspects requiring careful considerations.

The focus of this essay is on large-scale public infrastructure projects where the public somehow comprises a client and counterparty to a project company. The essay refers to construction projects within the transport sector to a significant extent and particular attention is paid to the financing model used for the construction of motorways in Norway. However, private public partnership can be used in a number of different sectors. Besides, the circumstances here examined are equivalent to those relating to project financing in general, without the client necessarily to be the public. Apparently there are certain aspects that require further examination. Should the exception apply to public private projects or be extended to

encompass project finance in general where the client is a private entity? What financing techniques should be acknowledged, what is a project company and how should the estate's right of entry be correlated to the financiers step in rights. The most fundamental task for a law reform is thus to consider such aspects and to make adequate demarcates and definitions. The proposal here presented is designed against the background of the balancing of interest accomplished above, however in order to make the law proposal efficient, certain interests is subjected to further evaluation as well.

The enquiry here to be examined is thus what projects and financial techniques the exception shall be extended to encompass, and what legal technique that should be used in order to devise such law proposal. Before these considerations are examined further, the wording of the exception for PPP in Norway is briefly presented.

9.2 The law reform in Norway

The legislative change in Norway is brought about as a section in the individual "Road Act" "Veglova chapter 4."¹⁴⁶ This chapter deliberates the economical responsibility, designing, construction and maintenance of public roads. The exception is very brief and stipulates:

Paragrafen her gjeld avtalar mellom vedkomande vegstyremakt og det selskapet som skal finansiere og stå for utbygging av ein offentleg veg, og stå for drift og vedlikehald av vegen i minst ti år etter at han er opna for trafikk.

Paragrafen gjeld berre dersom det følgjer av avtalen at minst halvparten av selskapet sitt vederlag skal betalast etter at vegen er opna for trafikk, og at dette vederlaget skal betalast i samsvar med avtalen fram til selskapet si plikt til å drifte og vedlikehalde vegen tek slutt.

*Om det vert opna konkurs i selskapet sitt bu, har konkursbuet ikkje rett til å tre inn i ein avtale som nemnt i paragrafen her.*¹⁴⁷

¹⁴⁶ lov 21. juni 1963 nr. 23 (veglova).

¹⁴⁷ Ny § 21 i lov 21. juni 1963 nr. 23 (veglova).

9.3. The scope of projects and financial techniques

The exception in the Norwegian law provision appears to provide poor guidance for what projects and legal techniques the exception, as far as Sweden concerns, should be extended to. Hence it is prescribed in the individual Road Act and solely applies to PPP concerning road projects. The exception is very restricted in a number of aspects, it solely encompasses public roads where the counterparty, the client, to a project company is related to the road department or the local authorities. Besides it is adjusted for the particular financing techniques that have been used for the PPP projects accomplished in Norway. There is a requirement for the payments from the public counterparty to be received subsequent to the accomplishment of the project and there is even a limit of half the compensation sum to be paid subsequent to the road has been opened for traffic and for the payments to sustain until the end of the contracting period.¹⁴⁸

9.3.1 Starting point

The starting point for the proposal here presented emanates from the balancing of interest accomplished above. In fact, the matter of decisive significance is where the interest of the senior lenders can be said to prevail over the interest of the other creditors. As long as this precondition is upheld there is no motive or interest speaking in favour of entitling the bankrupt estate to enter into the project company's contractual relationships and prevent the lenders from exercising their step in rights. This conclusion can besides be made against the background that the lender's step in rights increases the chances for the project to survive and hence can generally be said to be at advantage for the major creditors, save for the project sponsors.

So, in what situations can the interest of the lenders be said to prevail? The basic preconditions for the balancing of interest can in brief be summarised to where the financiers are exposed to a non- or limited recourse finance, hence where the borrower is a vehicle company and the assets of the project is limited and the repayments and interests payments of the loans are depended on the project's future revenues and the calculated cash flow. The project should also include step in rights. Besides, the balancing of interest encompasses projects where some kind of public interest can be distinguished and may be described as infrastructure projects in a broad sense. Apparently, the suggestion made here is to carve out a

¹⁴⁸ Vedlegg 20120, section 6.

general exception on the basis of a balancing of interest. However, the precise meaning of such balancing of interests and the legal technique that should be used in order to construct a law proposal must be deliberated closer.

9.3.2 Public private partnership or project finance in general

The defining of the scope of project encompasses the enquiry whether exceptions should be acknowledge solely where the client or counterparty is represented by the public or in relation to project finance in general. The essay predominantly deliberates the concept of private public partnership and hence where the public is the counterparty to a project company. However, the balancing of interest is pertinent with regard to project finance in general without the client necessarily to be the public.

The lenders are subjected to equivalent high-risk exposure (depending on the contracted terms) with regard to a private gas project for instance, where the repayment of the loan is depended on the project's future revenues and the cash flow and hence the key objective in order to make the project bankable is to preserve the cash flow. Whether or not the sum payable is to be obtained from a public counterparty does not accurately change the lenders situation. Besides, the public interest in such projects may be as pertinent as regards projects where the client is de facto the public. The factual meaning of public can also be questioned, should it be restricted to a public body, as in the Norwegian exception, or extended to public companies such as "Vattenfall" for instance? It appears that the borderline to a pure private company is not far away and there is no real interest for a legislative exception to draw such line. Such border could besides cause undesired and inequitable competitive disadvantages. Apparently, as long as there is some kind of public interest in the project that is to be constructed there are no reasons to restrict the exception to solely public private partnerships but to project finance in general where the interest of the lenders prevail over the interest of the other creditors. However, general competitive consequences, predominantly in the view of European Law, are nevertheless here recommended to be subject to further scrutiny.

However, the quandaries here examined are highly controversial and political and it is thus problematic to suggest an unbiased law proposal. Besides, it may appear controversial to suggest a general applicable exception for project finance in a broad sense, where the Swedish government has been reluctant to even admit financing through public private partnerships.

Albeit the quandary of involving the private sector in public services as a means of financing infrastructure projects is in contention, the question here examined is less divisive.

The current legal situation, *de lege lata*, as well as *de lege ferenda*, is most likely to acknowledge exceptions in relation to construction contracts in general. The public investigation presented so far, proposes that the basic provision shall not apply with regard to construction contracts.¹⁴⁹ It is thus unlikely for an exception relating to project financing in general, to appear controversial.

Against the background presented previously, the public interest of infrastructure and the high risk-exposure subjected to such large-scale projects appear to outweigh any objections that may encumber the efficiency of the financiers' step-in rights and the contracting parties' ability to cancel. With some reservations it is thus here recommended for the exception to be extended to larger project financing as well.

9.3.3 The scope of public private partnerships

The term public private partnership is very broad in several aspects. It can be used in a number of different sectors such as transportation, energy, waste management, housing, education and healthcare and encompass small as well as large-scale projects. Besides, it encompasses a whole range of arrangements where the magnitude of the private sector involvement varies. Public private partnership approaches can be arrayed across a spectrum, where at one end the public sector retains all responsibility for financing, constructing, operating and maintaining the project assets, as well as assuming all risks that are associated with the project; whereas at the other end, the private sector assumes all these responsibilities and risks.¹⁵⁰ Apparently, the concept is applicable even in cases not including a real financing, (where the public is responsible for this part).

Albeit financing through public private partnership so far is not used to a large extent in Sweden, several areas of public services are today performed by the private sector such as educational, nursing, and transportation sectors. (Up till now there has only been one infrastructure project that has been financed through a public private partnership, the so called

¹⁴⁹ SOU 2001:80 p. 221-222.

¹⁵⁰ Economic Commission, Guidelines, 2002, p. 13-14.

“Arlandabanan”.¹⁵¹) This is also a form of private public partnership, so called contracting out and management contracts, where the public sector simply enters into service and management contracts with the private sector.¹⁵² However this is not the form of partnership primarily referred to here.

The first and somehow obvious criteria for the interest of the senior lenders to prevail in accordance with the balancing of interest above, is for the partnership arrangement to include a financing. Contractual arrangements solely encompasses the maintenance of a public facility is thus outside the scope of this essay. However, it is another question whether the bankruptcy occurs during the maintenance period. The matter of decisive importance for the exception to apply is here suggested to be as long as the repayments and the interest payments yet not have fall due.

Whether the project concerns roads, gas or healthcare is off less importance for the purpose of this essay as well, nevertheless, the meaning of “public interest” must be closer defined, which is made below. Apparently, a law proposal can be extended to a number of sectors however the focus for this essay is on large-scale capital-intensive infrastructure projects. Accordingly, against the background presented above, the arguments invoked opposing the right of the estate to accede to the debtor’s contracts, primarily attach to high risk-exposure infrastructure projects such as motorways, railroads, bridges, water supply and energy facilities. However, save for some restrictions, there are no accurate reasons to restrict the application of the exceptions to solely such large-scale projects.

The financing techniques used (in project finance in general and) in public private partnerships varies to a large extent as well. The public private partnership form primarily referred to here is the technique used (and in use) in Norway for the construction of roads, the so called “build operate and transfer” technique (BOT). However, as far as Sweden concerns, whether and to what extent public infrastructure will be financed through private public partnership in the future, and what technique that may be used for this purpose, remain uncertain. If the legal opinion changes it is most likely for the partnership form to start within the transport sector as a form of BOT project. In fact there is already a Swedish model for public private partnership for large-scale infrastructure project within the motorway and

¹⁵¹ See for instance *Alternativ finansiering genom partnerskap*, p. 40-41.

¹⁵² European Commission, *Guidelines*, 2002, p. 21.

railroad sector, presented in conjunction with a report conducted in 1990 of the Ministry of Industry where the BOT model is suggested.¹⁵³

The application of the exceptions here presented is nevertheless somehow hypothetical. Besides, the techniques used in public private partnerships are subject to constant changes and improvements. A law provision prescribing exception must thus be flexible in order to encompass such factors. Furthermore, since it is here suggested for the exception to apply with regard to project finance in general it appears motivated to carve out a general worded exception narrowing down the basic precondition where the interest of the senior lenders can be said to prevail.

9.3.4 Non- or limited recourse financing

The interest of the lenders can be said to prevail where the financing is a non- recourse or at least a limited recourse financing. The general principle behind non-recourse financing is that the lenders have no recourse against the project sponsors and therefore only may take recourse to certain assets of the project company (or a joint venture of project sponsors) for the repayment of their loans and for interest payments on such loans.¹⁵⁴

Besides, as indicated previously, this factor is combined with the fact that the value of the assets that are held by the project company often are very uncertain. Under such non-recourse financing, the lenders therefore base their financing decisions almost solely on the projected future revenues from the project.¹⁵⁵ Both the equity holders and the creditors therefore focus their attention on the prospective future revenues of the project company. The most common way to achieve a non-recourse structure is to have a sole-purpose project company as debtor and owner of the project facility. In such cases the creditors have no recourse against the project sponsors as long as there is no reason to lift the corporate veil.

Under limited recourse financing structures, where the project sponsors have some, albeit very limited, responsibility for the project debt, the project can be owned directly by the

¹⁵³ A committee consisting of representatives from the Ministry of Finance and the Ministry of Industry, Employment and Communications was set up in the late 1990s in order to examine the pros and cons of using public private partnerships as an alternative method for financing of infrastructure projects. As part of its duty the committee carried out a legal review as well and found that the existing legal framework in Sweden allowed infrastructure projects to be established through public private partnerships. Näringsdepartementet, *Alternativ finansiering genom partnerskap*, Stockholm (DS 2000:65), 2000.

¹⁵⁴ Vinter, *Project Finance*, 1996, p. 111.

¹⁵⁵ Merna & Cyrus, *Financing and managing of infrastructure projects*, p. 110.

project sponsors. In these situations the project sponsors are the debtors under the project debt, however, their responsibility is limited contractually through limited recourse contracts.¹⁵⁶ The second situation that often gives rise to limited recourse situations is when project sponsors issue guarantees to the project creditors under what would otherwise be a non-recourse financing. The obligations contained in these guarantees are often limited to certain events and amounts, which limits the recourse against the project sponsors.

Furthermore, the feature of the future revenues and hence the contractual arrangements for this purpose varies as well. The repayments and interest payments of the loans can, as for the Norwegian road projects, be subjected to so called “availability charge”. In simple terms this mean that the payments from the public counterparty are received as long as the road is opened up and available for traffic. The payments are thus not dependent on the number of cars that factually pass the shadow toll, hence the project company do not take any market risks. This is called contract-tied revenues and they are received from a public counter-party who uses the off-take or distributes it to the end users. These contract-tied revenues are received based on so called off-take agreements or take-or-pay agreements.

The second category that project revenues can be divided into is market-led revenues. Market-led revenues are from services or products that are sold directly to the customers. These revenues are therefore exposed to market risks, which includes changes in demand for the services or products that are produced through the project facility, increases in costs of raw materials and consumables, changes in macro-economic parameters (for instance recessions and down-turns in the economy).¹⁵⁷ The conclusion that can be drawn when comparing these two categories of revenues is that market revenues hold a much greater uncertainty than contract-tied revenues.¹⁵⁸

However, the interest of protection for the senior lenders can nevertheless be said to be comparable for these two categories of future revenues since low risk is compensated with cheaper costs for the lending. Appreciably, the interest rates where contract-tied revenues are contracted are not as high as for market-led revenues.

¹⁵⁶ It should however be noted that such limited recourse contracts often are technically unsatisfactory and may not be available in all jurisdictions, Wood, *Project Finance*, p. 23.

¹⁵⁷ Merna & Cyrus, *Financing and managing of infrastructure projects*, p. 84.

¹⁵⁸ The risks associated with market led revenues can, however, be reduced by way of public party guarantees that have the same purpose and similar effects as off-take agreements. Vinter, *Project Finance*, 1998, p. 159-172

As mentioned previously, the focus on future revenues has several important implications. Apart from structuring the contractual documentation in order to secure the future revenues (through various clauses and arrangements that reduce the risks that the future revenues are exposed to), it creates incentives for on-time and within-budget implementation of projects. Furthermore, it provides an incentive for the project sponsors to adopt a “life-cycle cost” approach through which future costs for the operation and maintenance of the project facility can be reduced and made more consistent and predictable.¹⁵⁹ The savage consequences ensuing from an entry of the bankrupt estate must be appreciated against this background and can thus nevertheless be enough emphasised.

9.3.4.1 Acquisition of the project and complicated financial arrangements

Furthermore, it must be considered whether the exceptions should apply to lenders who lend money for the acquisition of a project. The exception should persuade the public interest of infrastructure and apply to risks subjected to (the construction and maintenance) of such projects and hence not apply to pure commercial capital speculative risks. This is here thus considered to be outside the objective of the exception.

It should be noted that such restriction may prevent the exceptions from apply to complicated financial structures such as in a cross-collateral financing structure on a portfolio basis with many borrowers and projects. This technique is used for some of the more sophisticated borrowing base financing in the North Sea. In this type of financing, a group of companies obtain cheaper finance because a number of companies in the group give security over their project assets securing not just their own individual borrowings but also borrowings by their sister companies in the group.¹⁶⁰

However, such complicated financial structures is not apparent in Swedish projects and it is besides highly unlikely for the bankrupt estate to even think about enter into such complex project agreements. It is not the intention here to prescribe exceptions for commercial capital speculative purposes, thus these aspects are beyond the scope of this essay and not commented further. However in order to prevent undesired legal uncertainty it is here recommended to further consider whether the exception should apply to such arrangements.

¹⁵⁹ European Commission, Guidelines, 2002, p. 22.

¹⁶⁰ Vinter, Project Finance, unpublished version from the 9 December 2005, chapter 8 and 13.

9.4 Relation to the project company's other contracting parties

As indicated above, the lenders generally seek to step into all the project company's contracts, occasionally as a form of cure period, and definitely with the intention to replace the old company where the survival of the project company appears to be without any prospects of success. Apparently, in order for the lender's step in rights to be efficient, the debtor's estate should not be entitled to enter into any of the project company's agreements. Besides, if the lenders are not entitled to step into these contractual relationships and instead being forced to search for new contracting parties, the arguments invoked that the lender's step in rights provide the better solution for the major creditors involved, are thus not apparent.

The Norwegian law proves inadequate in this regard and does not comment upon other contractual relationship save for the public counterparty. The Explanatory Notes briefly mentions the negative outcome for the subcontractors and that the estate is generally entitled to enter into these contractual relationships as well.

If the public party is entitled to cancel it is highly unlikely for the estate to enter into the project company's other agreements, since it is predominantly the project contract that correspond to certain value. Apparently this is nevertheless generally solved in the individual cases, however, legal uncertainty is an undesired factor in this regard, that may threaten the due performance of the project and hence its cash flow.

Albeit this is somehow outside the scope of this essay, hence the contractual relationship of the public party and the project company is primarily examined, the suggestion made here is for the exception to apply with regard to all of the project company's agreements and not solely the key project contract.

9.5 Correlation to step in rights

Furthermore it is essential to regulate the correlation to the step in rights. The quandary is thus whether the public counterparty (and the other contracting parties) should be given a general right to cancel or whether the contracting parties solely should be entitled to such right where a project has step in rights and more important, solely where the step in rights de facto are exercised. The Norwegian law do not comment upon the correlation to the step in rights. It is not even a condition for the project to be subjected to step in rights. The new wording of the

English Insolvency and Companies Act, concerning the abolishment of the right to appoint an administrative receiver, refers to projects that have step-in rights, however, do not stipulate any requirements for such rights to be exercised.

The situation is somehow different as regards the scenarios that are likely to apply in case of the project company's bankruptcy. What happens if the lenders do not wish to exercise their step in rights or whether such attempt results in that the lenders step out again? The most convenient solution for all the creditors and the contracting parties in this regard, could even be to enable the bankrupt estate to step in. Albeit it is decided for a law proposal not to prescribe particular provisions in this regard, it is nevertheless necessary to consider such scenarios. It appears that the Norwegian law has not foreseen the consequences if the lenders do not wish to step in or perhaps even more important, subsequent to a step out, hence the wording can be criticised to be excessively brief.

The suggestion made here is to open up for the estate to accede to the project company's contracts where the lenders do not wish to step in, or subsequent to an entry, wish to step out. However, against the background presented above, the solvent public party is likely to encounter inconsiderably inconvenience ensuing from the estate's right of entry and hence it is reasonable to provide the public party with the opportunity to choose. Nevertheless, this is somehow outside the scope of this essay, the most reasonable solution, and here presented, is that the estate should only be entitled to enter into the project company's contracts if the public counterparty consents.

Whether the other contracting parties should be entitled to prevent the estate from entry in these particular situations has not been deliberated in the balancing of interest above, however a proposal is nevertheless presented. The public interest can not be said to be as apparent as for the project contract entered into with the public, however given the unsecured creditors underprivileged position in the project company's bankruptcy, there are certain reasons to protect these parties as well. The other contracting parties are noticeably likely to encounter inconsiderable damages if they were compelled to performance.

Nevertheless, these scenarios are generally solved in the individual cases as well. Since the financiers in general base their decision to not step in or to step out, on the fact that the survival of the project company appears to be without any prospects of success, it is highly

unlikely that the bankrupt estate wishes to accede to the project company's contracts in these particular situations. However, legal uncertainty is a matter of concern, delays and doubts increase the risks and hence the costs for the project.

A law proposal should thus be upheld in order to endorse flexibility and for the parties to agree upon a common solution. However, if the parties can not agree, the most reasonable solution is to enable the other contracting parties with the opportunity to choose as well. This is also motivated by the fact that the law should seek to encourage private entities to participate in public private partnership projects without being exposed to inconsiderable risks. It is thus suggested here that the estate should only be entitled to compel performance of any contracting party to the project company, if the contracting party affected has consent.

9.6 Legal technique

Apparently, a law proposal must consider and acknowledge exceptions from the basic principle of the bankrupt estate's right to accede to the debtor's contract, in all the particular situations outlined previously. The basic criteria for a law provision is thus where the debtor is a project company, or a joint venture of project sponsors or where the project sponsors are the debtors under the project debt with limited responsibility through limited recourse contracts. Besides, the asset of the project company should be limited. The exception shall encompass both market led and contract-tied future revenues.

There are various kinds of legal techniques that can be used in the pursuit of narrowing down all these criteria. The primary matter of concern is somehow technical and deliberate where the exceptions should be prescribed.

9.6.1 Exceptions in individual acts or in the bankruptcy act

Given that a general legislative reform is underway a law proposal must be designed in order to remain efficient even subsequent to such law reform, or to be incorporated in conjunction herewith. The formulation of a coming law proposal prescribing general rules of the bankrupt estate's right of entry and the proposal of merging the two insolvency proceedings is thus uncertain. However most likely, in accordance with the public report (SOU 2001:80), is for general rules to be prescribed in the Bankruptcy Act or in an integrated Insolvency Act. The provisions are to be subordinated to any other act. However in keeping with the pattern in Denmark and Norway exceptions is held to be carved out within the section, where the nature

of the legal relationship otherwise require. In general the exceptions are held to be where the debtor's person is significant for the due performance of the agreement.¹⁶¹

Apparently, exceptions from the provisions regarding accession by the bankrupt's estate, with regard to the particular purpose for this essay, can be prescribed in individual acts or as an exception directly spelled out in the general provisions in the Insolvency Act.

Furthermore, it is likely for legislative changes to be brought into force ensuing from an increased willingness to make use of the partnership financing technique. However it appears that no extended legal amendments are required in order to carry out infrastructure projects through public private partnerships albeit several legal challenges (as the purpose for this essay) are likely to be solved. The primary concern in this regard is to what extent public services can be delegated to the private sector. Swedish law contains rules and regulations that stipulate that certain services must be delivered by the public sector and particular activities must be performed by public authorities. This is, for instance, regularly the case for activities that in one way or the other comprise the exercise of public authority.¹⁶²

The wording of the Norwegian law is dependent on the current wording of the Road Act. In order for a law proposal to be efficient it should be flexible and thus easily be subject to amendments in case of the private public partnership technique expands to areas beyond the sectors here examined.

The legal technique suggested here in order to achieve the outlined objectives is to carve out general worded exceptions, not reliant on the wording of applicable laws, and likely to apply to various forms of infrastructure projects. Unlike the Norwegian provision, the exceptions is here recommended to be prescribed in a supplementary section to the general provisions governing the bankrupt's estate's accession to the debtor's agreements, directly in the Insolvency Act. Whether further exceptions for other sectors of private public partnership projects are desired, such exceptions can be placed here as well. By avoiding regulations in individual acts, legal certainness and clarity can be upheld as well. Besides, this is motivated by the fact that there are no individual acts for all kinds of infrastructure projects likely to be concerned, where exceptions can be carved out.

¹⁶¹ SOU 2001:80 p. 219-222.

¹⁶² Näringsdepartementet, Alternativ finansiering genom partnerskap, Stockholm (DS 2000:65), 2000.

9.6.2 Guidance from exceptions in English law

Albeit the exception is to be general applicable and prescribed in the bankruptcy act, the provision could nevertheless be narrowly defined. The law provision in Norway as well as the English exceptions from the abolishment of the right to appoint an administrative receiver is depended on certain criterions as laws generally are.

Albeit the Norwegian proposal appears to be without useful help, significant guidance can be provided from the changes in the insolvency legislation in England, where a list of exceptions has been acknowledged in the Insolvency Act. Exceptions pertinent for this purpose can be summarised to public-private partnership projects, utility projects and larger project financing.¹⁶³ The exception relating to capital market arrangements is of possible interest to project financiers as well because it is drafted widely and it may present structuring opportunities for projects which would not for various reasons fall within one of the specific project finance exceptions.¹⁶⁴

The provisions are simply composed by a number of “technical” requirements that are to be met in order for the exceptions to apply. These requirements are defined below the main provisions.

The exceptions distinguish between PPP and project finance in general. The exception prescribed in the English Insolvency Act relating to larger project financings provides that the right to appoint an administrative receiver has not been abolished in relation to a *project company* of a project which is a *financed project*. A project is held to be financed if “*under an agreement relating to the project a project company incurs, or when an agreement is entered into is expected to incur, a debt of at least £50 million for the purpose of carrying out the project.*”¹⁶⁵

However, this wording has been subjected to scrutiny in a recent case, *Feetum v. Levy*. The judge, Lewison J considered the meaning of the phrase “expected to incur” and stated that: “*it seems to me that there is something more than merely a hope involved in an exception. An exception connotes at least some likelihood of that which is expected coming to pass.*” He

¹⁶³ ss.72B – 72GA of the IA 1986.

¹⁶⁴ S. 72 B of the IA 1986.

¹⁶⁵ s. 72D(1) of the IA 1986.

further held that there was no expectation that the company in question would borrow at least £50 million. Even though it might be said that the highest the company expected to borrow was up to £65 million, there was de facto no evidence that the level of borrowing was likely to be achieved and “up to is not the same as at least”.

As demonstrated in English case law, there is an infinite risk induced in such “technical” law technique. Where the matter of decisive importance is connected to certain definitions that focus on minimum sums etc, the legal judgement tends to turn away from the factual objective and the circumstances that are of essential importance. It can thus be questioned whether definitions should encompass minimum amount of the debt and such technical criteria at all. Besides, in view of the fact that the exception should be applicable to various forms of financing and contractual techniques, and to project finance in general, there is no reason to bind the exception to a particular model or definition.

As far as the exception under Swedish law concern, there are nevertheless no reasons to restrict the exceptions to such high sums as £50 million. It must be kept in mind that the English exceptions are related to a considerably far extended remedy than the Swedish quondam of the estate’s right to accede to the debtor’s contracts, nevertheless the outcome of the two remedies appears to coincide for these particular cases (where the survival of the company is depended on a single contract).

The objective here is thus that the provision and the exception shall apply where the interest of the senior lender’s can be said to prevail. The best way to achieve this is thus for the law provision to compel the judge to conduct a balancing of interest himself. Instead of focusing on technical criteria it is here suggested that the wording of the law should require the judge to base his decision on a balancing of interest. The decisive factors should thus not primarily be subjected to certain definitions but to a factual balancing of interest. In this way, consideration to the importance of openness as mentioned previously, can be met and hence the superiority of the principle of freedom of contracts is unlikely to outweigh other interest.

9.6.3 Presumption

The question is thus how this balancing of interest should be conducted. Naturally, the wording of the exception can be broadly defined and leave out for the judge to make a balancing of interest, utterly on his own, in each individual situation. However, such broad

judgement is unpredictable and may result in legal uncertainty. It is here suggested for the exception to carve out the typical situation where the interest of the senior lenders in general can be considered to prevail. Possibly, the provision may acknowledge the interest of the other junior lenders or creditors to prevail in exceptionally situations after a legal judgement in the individual case. However the law provision should stress that such exception (from the exception of the right of the estate to entry) should be applied restrictively, solely in extreme exceptionally cases. The legal technique suggested is thus for the law provision to lay down a presumption however pointing out that a balancing of interest is the factor of deceive importance.

Albeit, the intention here is to avoid definitions as far as possible, a number of criterions are nevertheless necessary if the law provision is to lay down a presumption. It is essential for a general applicable exception to prescribe well-weighted definitions and demarcates. Vinter criticises the English project finance exceptions to suffer from a curious lack of clarity and precision. He provides two examples in this regard; whether the exceptions apply to refinancing and if a simple real estate development is capable of benefiting from the financed project exceptions and be incorporated in the word “project”.¹⁶⁶ In fact the exceptions in the English insolvency and company laws provide extensive definitions of phrases like public-private partnership project, utility project, project company and related terms but nowhere in the new legislation is the word project itself defined. The consequences of such imprecise wording have been demonstrated in the same English case referred to previously. In *Feetum v. Levy*¹⁶⁷ it was acknowledged that project was not defined in the law provision and the judge saw no reasons to apply a particular limited meaning to it. It was accordingly held that a scheme to install advertising video screens in taxicabs was a project for the purpose of the relevant provisions of the Insolvency Act.¹⁶⁸

Noticeably this judgement confirm the importance for a law provision to oblige the judge to base his decision in line with the intended objective of a certain law provision however the importance of a law provision to express and define its objective is nevertheless demonstrated.

¹⁶⁶ Vinter, Project Finance, so far unpublished version from the 9 December 2005, chapter 8 s.3(e).

¹⁶⁷ Case No: HC04 C0393.

¹⁶⁸ Case No: HC04 C0393, The Times 24th January, 2005.

9.6.4 Proposal

The general requirement suggested here, in accordance with the balancing of interest above, is to acknowledge exceptions where the debtor has attained a non recourse or a limited recourse financing for the purpose of carrying out a *project* and the repayments and the interest payments of the debt is depended on the project's future revenues and cash flow. Since it is suggested here for pure capital speculative purposes to be outside the scope of this essay, the formulation "*for the purpose of carrying out the project*" is upheld, hence indicating that the exceptions should not apply to lenders who lend money for the acquisition of a project.

The provision shall thus prescribe that the interest of the senior lenders (to exercise their *step in rights*) prevails over any interest of the junior lenders or the other creditors to the debtor in these particular situations. In order for the "public interest" to be considered, the word project shall be included in this first section and closer defined underneath it, beside the term is to be italicized (underlined) in order to signify its intended particular meaning in accordance with the definition below. The intent is for the requirements prescribed in this first section to be satisfied in every case and hence the public interest is a general prerequisite for the exception to apply however without render the application too restricted. (The wording of the definition is prescribed below.)

The next section is here suggested to exemplify when a non recourse or limited recourse financing generally can be said to be attained, hence where the debtor is a *project company*, in relation to a *project* with limited recourses and which includes *step-in rights*. The intent is for the italicized (underlined) terms to be defined underneath as well (which is made here below).

Finally, a section shall carve out the exception that entitles the estate to enter into the debtor's agreement where the interest of the other creditors, for some exceptionally particular reason, can be said to outweigh the interest of the senior lenders.

9.6.5 Definitions

The suggestion made here is thus for the law provision to define the words "project", "project company" and "step in rights".

9.6.5.1 Definition of project

Since the English law provisions referred to previously do not define the word project, guidance can not be obtained from here. However, the intention behind the exceptions approved provides adequate help in this regard. Since the key objective is for the exception to apply in cases where the interest of protection for the lenders can be said to prevail, the term should not be narrowly defined. The objective here is thus for the exception to be generally applicable.

As indicated previously, public private partnership can be used in a number of sectors. It has already been indicated that the matter of decisive importance should not be whether the project concern nursing or transport project as long as the projects encompasses a financing and a broad public interest can be distinguished. Besides, no accurate reasons to restrict the application of the exceptions to solely large-scale projects have been demonstrated.

A broadly definition of infrastructure is thus here suggested, (partly as a means to encourage the private public partnership technique in Sweden). As far as the public interest of infrastructure is met certain limitation of the debt amount proves unnecessary and is likely to turn the attention of the scrutiny away from the public purpose and other essential factors. Besides, unlike the English law provisions, there are no reasons to define or use the term public private partnership, since one general exception here is suggested to incorporate both public private partnership financings and project finance in general.

The proposal presented here is in line with the intent behind the exceptions relating to project finance approved in English law. A project is to be distinguished from a commercial enterprise and the term project should be limited to investment in public or strategic buildings or infrastructure, including the energy and telecommunications sectors, and should not encompass purely private ventures which do not fall within the foregoing.¹⁶⁹ This wording is thus further elucidated when the exception is read as an entity and in conjunction with the other definitions.

However it is recommended for this as well as for all definitions here presented, to be subjected to scrutiny and to be amended and extended along with a possible development of

¹⁶⁹ Graham Vinter, Project Finance, chapter 8, so far unpublished version from the 9 December 2005.

the financing technique and PPP models used. The English definition of public private partnership is besides worth mention in case it is desired for the application of the exceptions to be extended in the future:

A public-private partnership project is a project:

“(a) the recourses for which are provided by one or more public bodies and partly by one or more private persons, or

(b) which is designed wholly or mainly for the purpose of assisting a public body discharge a function.”¹⁷⁰

9.6.5.2 Definition of project company

The Norwegian law do not use the wording public private partnership (Offentligt Privat Samarbete, OPS) and it is pointed out in the explanatory notes that the term entity (“*selskapet*”) is used in order for the exception to be applied broadly and encompass various forms of associations.¹⁷¹ It is essential for the meaning of “project company” not to be narrowly defined since there are various forms of associations and entities likely to participate in a public private partnership and in project finance in general. The exception is thus to be applicable in the cases where a limited recourse financing is attained as well, where the project sponsors are the debtor and where the joint venture form is used etc. The provision must thus clarify that the term project company shall not be restricted to a particular association form or even restricted to any association at all but to various forms of entities.

However in order for the “public purpose” to prevail and not to encourage commercial speculative purposes it is here suggested for the definition of project company to relate to the purpose or the accomplishment of the project. The wording of the Norwegian law suffers from such provisions.

Essential guidance can be provided from the English provisions here as well. Against the background of the balancing of interest presented above, the exception should apply to project companies that have the sole or principal responsibility under an agreement for carrying out all or part of the project. This is predominantly pertinent where the project company is granted a public concession agreement. However, in order for the general project finance

¹⁷⁰ S. 72C(2), see as well (1) of the IA 1986

¹⁷¹ Vedlegg 20120, p 10

exception to be applicable and for more complicated financial structures to be approved, the definition must be extended further. A company carrying out a power project in Sweden cannot be said to have any responsibility under any agreement to carry out the project, but it will receive no revenues if it does not.¹⁷²

The English draftsmen have clearly accepted that many projects are carried out and financed through fairly complex corporate structures involving a number of sole purpose companies and it is held that in order to give effect to the spirit of the exceptions for project finance, it must still be possible to appoint an administrative receiver over each of those companies. Finance vehicles and property-owning companies are therefore included within the definition and there is an acceptance that a company can be a project company simply if it can be said to carry out the project together with a number of other companies.¹⁷³ Holding companies are also included. This is important with regard to the appointment of an administrative receiver, because such appointment over the main project company (i.e. the company with the project's assets and main contracts) is undesirable because it may, for example, cause essential consents and licences to be terminated. This is pertinent in this regard is well.¹⁷⁴

There is a requirement in the English provision that companies cannot carry out unrelated functions if they are to qualify as *project companies*, which is suggested to apply in the proposal here presented as well.¹⁷⁵ It should be noted that the requirement in relation to unrelated functions also applies to holding companies. It is therefore submitted that a holding company which holds shares in a project company but also in another company which is not a project company will not itself be a *project company*. This is a means to ensure that the holding company only holds shares in companies which are *project companies* for the project in question.

Furthermore, it is here suggested to be prescribed in the Explanatory Notes, however not necessarily regulated directly in the wording of the law, whether, in relation to the unrelated function test, a company will take itself outside the project finance exceptions if, subsequent to its lenders advancing funds, it undertakes an unrelated function (possibly in breach of an undertaking in its finance documents not to do so). It is submitted that the result should

¹⁷² The example is provided from Vinter, unpublished, chapter 8 section (f)

¹⁷³ in paragraph (c)

¹⁷⁴ Para 7(1) of Schedule 2A to the IA 1986, see as well Vinter, unpublished, 2005, chapter 8 section (f)

¹⁷⁵ Para 7(2) of Schedule 2A to the IA 1986

depend on whether the lenders took an undertaking from the company not to carry out unrelated functions and on whether, if they did, they took no action upon becoming aware of a breach. If the lenders did not take such an undertaking (or if they knowingly acquiesced in a breach) a court could legitimately hold that they took the risk of the company carrying out unrelated functions and no longer being a project company as a result. Otherwise, a court should not fundamentally alter the nature of the lenders' rights simply because of action taken by their borrower in breach of covenant.¹⁷⁶

9.6.5.3 Definition of step-in rights

The definition of step in rights in the English provisions refers to where a person who provides finance in connection with the project has a conditional entitlement under an agreement to assume responsibility for carrying out all or part of the project or making arrangements for carrying out all or part of the project. The inclusion of the last section is made for the same reasons as previously mentioned (considering the definition of project company), because the reference *to responsibility under an agreement*, is not appropriate for a number of other more general projects (such as power projects). This definition corresponds to the balancing of interest made above and hence is suggested to apply in the proposal presented here as well.

It remains somewhat curious that the draftsmen think that step-in rights are the touchstone of whether or not an administrative receiver can still be appointed in relation to a project in England. The typical way to *step into* an English company is to appoint an administrative receiver over it. As a result, the legislation almost achieves the rather odd and circular result of stating that lenders may appoint an administrative receiver over a company involved in a project if they have reserved themselves the right to appoint an administrative receiver. Indeed, in *Feetum v. Levy* the judge held that the mere fact that a lender could appoint a receiver was not sufficient to enable a lender to have *step-in rights* for the purposes of the project finance exceptions.¹⁷⁷

However as far as jurisdictions with no receivership remedy concerns, like Sweden, these judgements provide poor guidance. However, the same circular result is apparent here as well since the basic question examined for the purpose of this essay is the efficiency of direct

¹⁷⁶ This reflection is made by Vinter in, Vinter, unpublished, 2005, chapter 8 section

¹⁷⁷ Case No: HC04 C0393, The Times 24th January, 2005, Vinter, unpublished 2005, chapter 8 section (f)

agreements and step in rights under Swedish law. However, against the background of the balancing of interest above, the requirement for the project to include step-in rights is essential.

9.7 Law proposal

The law proposal is as follows:

The interest of the senior lenders to exercise their *step in rights* shall prevail over any interest of the junior lenders or the other creditors to the debtor, and consequently the bankrupt estate shall not be entitled to enter into the debtor's contractual agreements and compel performance;

where the debtor has attained a non recourse or a limited recourse financing for the purpose of carrying out a *project* and the repayments and the interest payments of the debt is depended on the project's future revenues and cash flow

A non recourse or limited recourse financing is generally attained where the debtor is a *project company*, in relation to a *project*, with limited recourses, and which includes *step-in rights*.

The interest of the other creditors may in extreme exceptionally cases be considered to outweigh the interest of the senior lenders, this fourth section shall apply restrictively.

These provisions shall not apply if the senior lenders consent to entitle the estate to enter. Where the senior lenders declare that they do not wish to exercise their step-in rights, or where they, subsequent to a step in, declare that they wish to step out, the parties shall seek to agree upon a common solution. If such common solution is not achieved, the bankrupt's estate is only entitled to compel performance if the contracting parties consent.

A project:

is to be distinguished from a commercial enterprise and the term project should be limited to investment in public or strategic (buildings or) infrastructure,

including the energy and telecommunications sectors, and should not encompass purely private ventures which do not fall within the foregoing

A company is a *project company* of a project if:

- (a) *it holds property for the purpose of the project,*
- (b) *it has sole or principal responsibility under an agreement for carrying out all or part of the project,*
- (c) *it is one of a number of companies which together carry out the project,*
- (d) *it has the purpose of supplying finance to enable the project to be carried out, or*
- (e) *it is the holding company of a company within any of paragraphs (a) to (d).*

The term company shall not be restricted to certain form of association and encompasses all kind of entities constructed for the purposes above. This provision shall also apply where the project sponsors are the debtor but have attained limited responsibility contractually through limited recourse contracts.

A project has *step-in rights*:

if a person who provides finance in connection with the project has a conditional entitlement under an agreement to –

- (a) *assume sole or principal responsibility under an agreement for carrying out all or part of the project, or*
- (b) *make arrangements for carrying out all or part of the project.*

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The Times 24th January, 2005