

## Flash : The French trust

The French trust for financing infrastructure

September 2011

*Fiducie (French trust) is a useful tool in financing of infrastructure projects in concessions or public-private partnerships. Fiducie is a mechanism providing flexible and robust collateral that increases lenders' protection over the essential assets of the project. This provides better control of the project continuity in the event of failure of the Special Purpose Vehicle (SPV). As a segregation mechanism of assets and liabilities of the project, fiducie can also be a substitute for the SPV. Lastly, under certain conditions, fiducie allows sponsors to deconsolidate the project and the liabilities attached thereto.*

### Collateral trust on the project assets

The quality of collaterals on cash flows and the preservation of these cash flows through the control of underlying project contracts are essential in the event of the failure of the project company, or transfer of the project. Security interests on assets other than revenues and contracts aim primarily at ensuring the integrity of the SPV in the event of failure, or project transfer.

### Cash flows

French standard types of collateral over debt receivables - assignment of receivables (« *cession Dailly* »), pledge (« *nantissement* ») and delegation (« *délégation* ») - ensure that creditors have an exclusivity right in case of insolvency over existing and future receivables granted as collateral, appreciated by the project financiers. This exclusivity is however limited to a pledge and postponed for a non novatory delegation to the date of payment by the delegated debtor.

Like the Dailly assignment of receivables, the French trust as collateral gives rise to an absolute right of exclusivity, but contrary to the Dailly it benefits all investors and not only credit institutions. The neutral trustworthy position of the *fiduciaire* (trustee) allows him to administer cash flow waterfalls for the benefit of creditors of different ranking classes. It also allows through a control over the renewal process of contracts such as offtake agreements the assigned receivables of which have a term shorter than the facility maturity date, to render futures receivables under such contracts determinable even though the debtor and the price are not yet known .

### Underlying contracts

The collateralization of the SPV's contracts (such as concession, long-term property lease and offtake contracts) or of the resulting rights of the project company facilitate control by the financiers of the continuation of these contracts which are essential to the continuity of the project in case of a SPV's failure. Secured creditors may then be substituted to, or designate a substituting third party to the SPV in such contracts. In addition, they can be granted the right, when the SPV is in default vis-à-vis its contractors, to postpone the termination of the contract for the time necessary for the financiers to cure the financial default, or to find a new project company to which the contract will be transferred.

As a general rule, under French law, contracts or contractual rights are not eligible to standard collaterals. Accordingly, the substitution of lenders to the defaulting SPV (step-in rights) and the temporary suspension of the termination right of the defaulting SPV co-contracting party are usually provided for through straightforward contractual agreements between contractors and financiers, the effectiveness of which is uncertain in the event of a project company's insolvency.

The French trust as collateral broadens the scope of assets that can be collateralized, which can include concession, long term lease and offtake contracts. It ensures an effective control of these contracts through the rights recognised to the fiduciary and their transfer to a third party pre-approved by the granting authority. However, in the event of a project company's insolvency, the transfer of these contracts to another operator will be suspended if the project company is using such contract or any collateralized right, except with the consent of the receiver.

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**Other assets**

The French trust as collateral has various advantages as compared to standard collaterals. As universal collateral, it applies to assets of all kinds, including rights not eligible to standard collaterals (for example, right of use of a photovoltaic plant, right of way in a telecommunication cable or going concern prior to the existence of a clientele) governed by a homogeneous set of rules whereas the heterogeneous enforcement rules render more delicate the synchrony when enforcing various security interests. In addition, all assets placed in a French trust used as collateral can be attributed to the creditor or the beneficiary designated by it whereas a commissory pact is prohibited for certain collaterals such as the pledge of a going concern.

**Shares of the SPV**

The shares of the SPV are generally pledged in favor of the financiers. The commissory pact attached to a pledge ensures the allocation of shares and the control by creditors over the project in the event of failure of the SPV. Nevertheless, it has two drawbacks. Firstly, the absence of any right of control for creditors over the management of the SPV until the occurrence of such event and, secondly, the possibility for the management of the SPV to paralyze the enforcement of collaterals by the commencement of insolvency proceedings. If the SPV's shares are transferred to a French trust, the fiduciary can, in case of a merely potential event of default, take control and prevent the opening of insolvency proceedings, and, even in such circumstances transfer the project, provided that the shareholders have not retained the use or enjoyment of the assets in the French trust, which will normally be the case if they have no operational control over it and if they receive no income during the debt repayment phase.

**Fiducie as a substitute for SPV**

The SPV has a segregation function of the project assets. The French trust agreement produces the same effect due to the waterproof nature of the French trust property vis-à-vis creditors of sponsors. One can then consider removing the SPV corporate structure and have a French trust which will directly hold all project assets and liabilities. The fiduciary will use the managerial skills of the operator and will delegate the tasks that it cannot provide itself. It will administer contracts for the benefit of financiers and sponsors and allocate cash flows in accordance with the rights of the different construction companies, contractors and financiers.

Unlike the SPV, French trust has the advantage that it may not be subject to an insolvency procedure. Thus, when the French trust defaults, its operational capacities are rearranged in accordance with the requirements of the creditors, without the intervention of the receiver.

The French trust will directly contract the bank facilities needed for the project funding. Deprived of legal personality, it is not empowered to issue bonds, but the latter may be issued by a finance company owned by the sponsors which will contribute the proceeds of the issue to the French trust.

**Deconsolidation**

According to the general provisions applicable to consolidated financial statements, the entity required to consolidate the French trust is that which exercises control over it. Under specific provisions applicable to the French trust, that are considered a priori equivalent to special purpose vehicles, the settlor is presumed to exercise that control. Within the framework of infrastructure financings, settlors should generally be sponsors. In order to determine whether or not the settlor controls the French trust, it must be considered:

- whether it has decision-making powers, with or without management powers over the French trust, or its assets, even if these powers are not effectively exercised;
- whether it has *de facto* the ability to receive the majority of the economic benefits of the French trust (in the form of allocation of income or the right to a proportion of net assets or to the majority of the remaining assets in case of liquidation);
- whether it bears the majority of the risks relating to the French trust.

The first criterion for decision-making powers is predominant. As a consequence, the French trust is controlled if the conditions of the first and second criteria or the first and third criteria are met. The French trust is also considered to be controlled when the second and third criteria are met. In practice, the loss of the decision-making power by the settlor is crucial to assess the loss of control. The conservation of the majority of risks and economic benefits related to assets transferred to the French trust constitutes a presumption of retention of a significant part of the effective decision making power.

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The settlor is, in particular, deemed to retain control over the French trust:

- when it is the sole beneficiary;
- when it retains almost all of the risks and benefits related to the transferred assets;
- when it retains the benefit of the residual interest over the asset or assets at the end of the contract through return of full property thereof.

In order to give the settlor the best chance to avoid consolidating the French trust, it is necessary to take several precautions: providing the involvement of several settlors and beneficiaries; implementing an effective pooling of risks and benefits within the French trust; providing, if possible, the transfer of fungible assets, and when the French trust property is insufficient, providing the transfer of all or part of the liabilities to the *fiduciary*.

The French trust mechanism allows to optimize and better secure the financial model of projects in which the rights of lenders are administered by a trustee for the whole duration of the project. It is a particularly valuable tool when the duration of the project exceeds the horizon of the holding of debt by financiers. It is a trend that will increase in the context of Basel III standards which prescribe the allocation of long-term resources to long-term uses.

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