World Bank Guarantee Products: Partial Risk Guarantees in Support of Privatizations and Concessions

World Bank Guarantees catalyze private financial flows to developing countries by mitigating critical government performance and payment risks that private financiers are reluctant to assume. Guarantees provide support to lenders or project companies against a government's (or government entity's) failure to meet specific contractual obligations to a private project.

Introduction

Partial Risk Guarantees (PRGs) cover private lenders or investors/project companies, through shareholder loans, against the risk of a government (or government-owned entity) failing to perform its contractual obligations with respect to a private project.

PRGs of International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) help to catalyze private sector finance in support of green-field private infrastructure projects. PRGs can also be used to facilitate the privatization of existing infrastructure assets, or concessions where the ownership remains with the government.

PRGs can be structured flexibly to suit the specific transaction circumstances and needs of governments and private investors. The following are examples of two different types of PRG structures where the investors/project company was the ultimate beneficiary of the PRG support.

PRG with a Letter of Credit Structure

Under the Letter of Credit (L/C) structure the PRG is designed to provide risk mitigation through a standby L/C facility opened by a governmental entity in favor of the project company. The project company is entitled to draw on the L/C upon a cash flow shortfall resulting from a government/regulatory non-compliance of its contractual undertakings to the project company as set out in a Government Support Agreement which is backstopped by the PRG. In the event of a drawing under the L/C by the project company, the government's repayment obligation to the L/C bank of the amounts drawn is guaranteed by the PRG under a Guarantee Agreement concluded with the L/C bank. The L/C bank could be either an international or domestic bank.

This structure is particularly suited to projects in which easy access to a source of pre-allocated liquidity (through the L/C) in the event of a government breach, is critical to project sustainability such as power or water distribution privatizations or concessions. This structure could also be used to support direct on-going government payment obligations (e.g. subsidy payments or minimum revenue guarantee payments).

PRG with a 'Deemed' Loan Structure

Under the Deemed Loan structure the PRG is designed to provide risk mitigation to the private investors/project companies through a shareholder loan facility ('deemed loan') from the project company/concessionaire to the government or government entity. The 'deemed' loan would consist of amounts owed by the government to the company/concessionaire resulting from a government non-compliance of its contractual undertakings as set out in a concession agreement. The repayment of the 'deemed' loan by the government to the company/concessionaire is guaranteed by the PRG.

This structure is more suited to the backstop of termination risks where the government would have a one time termination payment obligation, instead of ongoing payment obligations. This structure also has the advantage of PRG support being provided for the entire term of the concession, thereby enabling the project company to mobilize finance from lenders at any stage of the concession, as required.

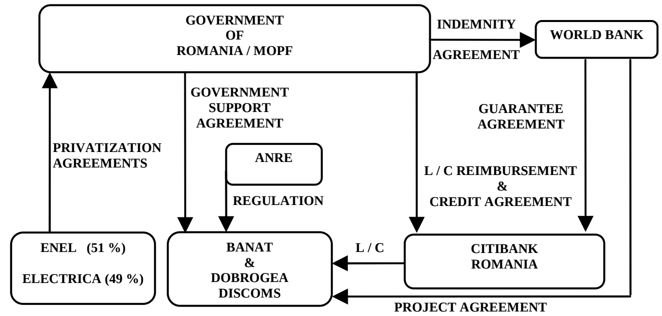
Partial Risk Guarantee with a L/C Structure: Romania – Privatization of Power Distribution Companies (2005)

The Government of Romania (GOR) undertook privatization of the majority asset (51%) of the first two of its eight regional electricity distribution companies, Banat & Dobrogea (Discoms). The Discoms will operate under a 25-year distribution license and a 8-year supply license for retail supply. Distribution revenues are regulated by the National Energy Regulatory Authority (ANRE) on the basis of a price cap/price basket methodology introduced in January 2005. To mitigate regulatory risks arising from the new regulatory framework, the World Bank provided an IBRD PRG backstopping GOR's obligation to compensate the Discoms for loss of regulated revenues resulting from non-compliance by the regulator and/or change or repeal by GOR of the pre-agreed regulatory framework[1]. *The Government Support Agreement* between the GOR and the Discoms details the guaranteed events, the claim and dispute resolution mechanisms.

The PRG was structured with a Letter of Credit (L/C) issued by a commercial bank for the benefit of the two Discoms. If a guaranteed event occurs and the event of default is not remedied within the prescribed 'cure periods' the Discom(s) would be entitled to draw under the L/C. Following a drawing, the GOR, through the Ministry of Public Finance (MPF), would be obligated to reimburse the amounts drawn, plus accrued interest, within 12 months. If GOR failed to make the necessary payments, the L/C issuing bank would have recourse to IBRD under the Bank's *Guarantee Agreemen*t concluded with the L/C bank. The L/C and the PRG are for a maximum amount of EUR 60 million for both Discoms and the L/C is valid for 5 years. IBRD also concluded *an Indemnity Agreement* with Romania and a *Project Agreement* with the Discoms. Financial closing of the *Privatization Agreement* between the GOR and the investor Enel of Italy, as well as the PRG, was achieved in April 2005.

The PRG facilitated the successful conclusion of the transaction and helped to reduce the Weighted Average Cost of Capital (WACC) requirement of the investor which served as a benchmark for subsequent privatizations. This transaction was the first PRG to be provided by the World Bank in support of a privatization transaction.

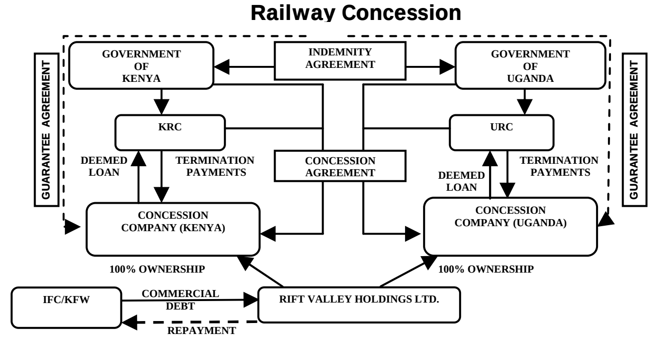
L/C Structure for Privatization of Power Distribution in Romania



Partial Risk Guarantee with a 'Deemed Loan' Structure: The Kenya-Uganda Railway Concession (2006)

The governments of Kenya and Uganda jointly undertook the concessioning of their respective railway systems to improve the management, operational, and financial performances of the two networks. All railway assets were conceded by Kenya Railways Corporation (KRC) and Uganda Railways Corporation (URC) to the concession companies at the commencement of the concession. The concession companies will be responsible for the rehabilitation and maintenance of the system, the achievement of minimum investment levels and traffic growth targets, and the payment of concession fees. The World Bank provided two separate IDA PRGs in support of the respective concession companies under 25-year concessions for their entire term, covering the risk of government non-payment upon termination for liquidated damages as well as KRC and URC's payment obligations relating to the 'conceded assets' accounts. Each PRG was structured to backstop a 'deemed loan' extended by the concessionaire to the government. This was the first PRG provided for a transport project which helped to catalyze around US$120 million of upfront financing for critical investments.

'Deemed Loan' Structure for Kenya-Uganda Railway Concession



For more information on the World Bank Guarantees, please refer to the web site: *www.worldbank.org/guarantees*

[1] relating to:(i) the distribution tariff formula and (ii) the full pass through of the electricity costs