by World Bank Borrowers and the World Bank as an Executive Agency."[41]

The contractual arrangements between the World Bank and its borrowers would comprise of a "loan agreement" which may be accompanied by a "guarantee agreement" or a "project agreement". The terms of the Bank's loan agreements differ from commercial loans to developing countries primarily they being attached to a specific project and through the medium or long-term structure of the loans.

**The structure of the Loan Agreements**

The World Bank Loan Agreements have attained a kind of uniformity and have assumed a standardization. The financing operations of IBRD and IDA are conducted through IBRD loan agreement and IDA development credit agreeement. There are specific instances in which these agreements may be supplemented by a guarantee agreement, project agreement and by covering letters depending upon the specificity of the loan. However, there are certain other instruments which would form an integral part of the original basic agreement. For instance, the "General conditions Applicable to the Loan and Gurantee Agrements in the case of IBRD Loans; and the "General Conditions Applicable to Development Credit Agreements" as in the case of IDA loans.

The World Bank's standardized loan agreements are said to be kept as deliberately short.[42] However, they include various definitions that are relevant to the agreements such as the parties to or the entities involved in the loan. Further stipulations relate to the loan conditions; particulars of development project; provision relating to security and the appointment of agents. The loan agreements may, in relevant cases, have annexes concerning the payment and redemption of the loan, the description of the project, procurement guidelines etc.

In the event of a legal entity of a member State such as an enterprise or regional authority entering into a loan/credit agreement and if the member State is not a direct party to the loan agreement, the arrangement automatically ensures that the World Bank has the member State as its guarantor. The usual formula in this regard is:

41. Edited by the World Bank in August 1981.
42. See: Hans G. Petersmann, "The Development Loans and Co-financing Operations of the World Bank", in *Law and State*, Vol. 32, pp. 74-95 at p. 77.

"The guarantor hereby unconditionally guarantees, as primary obligor and not as surety, merely the due and punctual payments." Thus a separate commitment is established by the member State.

Although the World Bank is an international lending institution and proclaims development as its motto, the safeguards that it seeks for its loan, in the agreements would be interesting to note.

One of the most important legal safeguards that World Bank seeks is the cross default clauses in the agreement. The cross default clauses empower the World Bank either to suspend or accelerate all other financing parties should any default occur in the servicing of any single loan or guarantee agreement.[43] Although no borrower would like to declare a default for economic and other reasons that may weigh in favour of continuous repayment, this clause is inserted for reasons which is not quite comprehensive. Stipulations such as *pari passu clauses*[44] and *negative pledge clauses* [45] are also found in these agreements.

**Co-financing by World Bank and its Legal Aspects**

The method of co-financing by World Bank implies the supplementing its own development loans by other external sources of finance. These reserves may include possible agencies—i.e. States or international development organisations, or an export credit agency, or commercial banks or other private investors. What is to be noted is that while organising its co-financing, the World Bank follows the principle that, ultimately, the borrower or guaranteeing member State is responsible for selecting the co-financier and for concluding the agreements with them. Thus, the World Bank merely provides assistance and acts as an intermediary. In practice, it takes the initiative for co-financing because of its links with official sources of deveopment aid, export credit agencies and commercial banks. While doing so, the World Bank leaves the negotiation of co-financing loan to the co-financier and the borrower. It is their exclusive responsibility to find agreement on the terms and conditions of the loan, such as

43. Some similarities with commercial loan agreements as far as the cross default clause is cocerned. See *infra*.
44. i.e. Bank's claims do not rank after third party claims. In other words, the World Bank loans should be treated equally with other loans as far as the borrower's obligations are concerned. For further discussion on the natue of this clause see *infra*.
45. In the event of third parties loans are promised with material security, then the same treatment should be given to Bank's loans on an equal footing.

interest rates, terms payment and redemption dates, currency aspects, or any security and guarantees.

The main feature of the traditional or standard co-financing is the separate legal status of the normal World Bank loan agreement and the associated co-financing loans.[46] While the World Bank's loan agreements are subject to the law of co-financier, the applicable law is private law of the commercial bank, in the event of the Co-financier being a consortium. The legal links between the two loans are established by a "Memorandum of Agreement" between World Bank and the Cofinancier (in the case of Commecial banks the co-financier is the lead manager) and also through "*cross reference clauses*," "*cross default clauses*" or "*cross effectiveness clauses*". A typical memorandum of agreement would contain an undertaking for reciprocal exchange of information and consultation in relation to the implementation of the project and the borrower's financial situation.

However, the World Bank's practice relating to co-financing especially with the commercial banks would appear to have taken a new form in which the bond between World Bank and co-financier is sought to be stronger than the traditional co-financing. That is to say, the World Bank takes a participation (between 10% and 25%) in a syndicated loan with international commercial banks for the same development projects (this is called B-loans). This is in addition to its own loan for the project (this is called A-loan).[47]

The structure of B loan is similar to the structure of a commercial bank loan.[48] The typical matters regulated by it are the redemption conditions, interest rates, fees, guarantees, and other security, right of cancellation if the performance are disrupted, cross default clauses, the choice of law, legal venue, renunciation of immunity and enforcement. Like commercial loans, these B-loans are usually governed by the Law and Court of Jurisdiction of the lead bank or another.

*Settlement of disputes Relating to World Bank Loan Agreement*

The loan and guarantees that are entered into by the World Bank Group and the borrowers are subject to and governed by public international law. This is due to the fact that the World Bank and its affiliates are subjects of international law endowed with international

46. Petersmann, n. 45 p. 83.
47. *Ibid*, p. 86-87.
48. *Ibid*, p. 88.

legal personality. So also its borrowers, i.e. sovereign States. Thus the relationship between them are governed by international law. Moreover, keeping in view its status as a specialised agency of the United Nations, the World Bank has, since 1960's, been registering all its loan guarantee agreements, with the Secretary-General of the United Nations, in accordance with the Article 102 of the United Nations Charter. The loan agreement concluded with a public or private enterprise is also governed by international law by virtue of the fact that the concerned member State is made as the primary obligor. Thus, the World Bank removes all its loan agreements from the purview of the national legal system of the member State in question.

The disputes arising out of the loan agreements are expressly sought to be settled by recourse to international Arbitration. However, it may be pointd out that there has never been an occasion of default by any member and the Bank as a matter of policy never agrees for rescheduling of a loan. These factors make the member governments comply with repayments.

**(ii) International Monetary Fund**

The International Monetary Fund (IMF) is a partner of the World Bank originating from the same Bretton Woods Conference. The purposes of IMF are to promote monetary cooperation through a permanent institution providing machinery for consultation and collaboration on monetary problems to facilitate the expansion and balanced growth of international trade, to promote exchange stability and avoid competitive exchange stability to assist in the establishment of a multilateral payments system and the elimination of foreign exchange restrictions hampering the growth of World Trade, to make its resources available to members so as to enable them to correct maladjustments in their balance of payments and, generally, to shorten the duration of the disequilibrium in the intenational balance of payments of members.

In course of its existence the IMF has had effected many amendments with the objective of relieving some of the financial strains of developing countries. Some of these amendments resulted in the establishment of facilities such as Special Drawing Rights (SDRs), compensatory Financing Facility (CFF), Bufferstock Financing Facility (BSFF), Extended Fund Facility (EFF), Oil Facility (OF), Subsidiary Account and Trust Fund.

IMF's attitude towards the developing countries has become controversial particularly relating to the conditionality attached to access to its resources.[49] The IMF has been advocating that internal adjustment by member countries is the workable means of achieving balance of payments equilibrium.

As mentioned in our earlier briefs,[50] the IMF advances loans with conditionalities as follows :

The liberalisation of external trade and payments, and in particular the removal of import controls, foreign exchange controls and other protectionist measures;

The removal of restrictions on the activities of foreign capital, such as discrimination against foreign capital; in particular branches and sectors and limitations on the transfer of profits;

The devaluation of national currencies (frequently, the payment of individual transfer of loans already granted is made dependent on additional devaluations);

The reduction of state subsidies for food, health and transportation which low income groups; changes in budgetary policy intended to reduce direct and indirect taxes on companies and to increase direct or indirect subsidies for companies (e.g. Provision of investment, finance, infrastructure and industrial inputs);

A reorientation of national economic policy and development towards increased promotion of production for export, with the concomitant neglect of areas producing for domestic demand and consumption, and an eventual increased dependence on imports;

State intervention in the determination of wages and other incomes, whereby notwithstanding the free market principles otherwise propagated by IMF the state is assigned the role of guaranteeing low wage level.

These conditionalities have led to an unhappy and discouraging situation for the developing countries. Hence they are seeking reform of the IMF through the committee of Twenty of IMF.

49. For a critical appraisal of IMF's policies from the perspectives of a developing country, see the Address by Mr. Alan Garcia, the President of Peru, to the Fortieth Session of the U.N. General Assembly, A/40/PV/5, 23rd September 1985, p. 11, 12.

50. Debt Burden of Developing Countries: A Preliminary Study of the Issues and Prospects, AALCC/XXV/9, pp.11-13.

**(iii) OPEC Fund and its Loan Agreements**

The OPEC Fund for International Development was established by the member countries of the Organisation of Petroleum Exporting Countries (OPEC)[51] in January 1976.[52] Its objective is to reinforce financial co-operation between OPEC member countries and other developing countries by providing financial support to assist the latter countries in their economic and social development.[53]

The Fund was conceived as financial facility which would consolidate the assistance extended by its member countries. Its resources are additional to those already made available through other bilateral and multilateral aid agencies of OPEC members. The Funds' eligible beneficiaries are the governments of developing countries other than OPEC members and international institutions whose activities benefit developing countries.[54]

The Fund began its operations in August 1976 with initial resource of about US $ 800 million. Its resources have since been replenished three times. They have been further increased by: the profits accruing to seven OPEC member countries through the sale of gold held by the International Monetary Fund; the contributions made through the Fund to IFAD; and the Fund's accumulated net income.[55]

Since its inception, the Fund has launched six leading programmes. The first five have been fully implemented. Besides extending loans on concessional terms for project programme financing and Balance of Payments (BoP) support; the Fund has also provided outright grants in support of technical assistance, food aid, research and similar activites.

The Fund's concept of Development strategy has been spelt out in the following words of the Fund's Director General: "We are

51. OPEC members are: Algeria, Equador, Gabon, Indonesia, Islamic Republic of Iran, Kuwait, Socialist people's Libyan Arab Jamahiriya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

52. For a detailed information relating to OPEC's evolution and functioning see: Ibrahim F.I. Shihata *et. al.* "*The OPEC Fund for International Development: The Formative Years*" (Croom Helm, 1983).

53. See Article 2, "Agreement Establishing the OPEC special Fund", in *International Legal Materials*, Vol. XV, 1976, pp. 1357-1366 at p.1357.

54. Two such institutions are: International Fund for Agricultural Development (IFAD) and Common Fund for Commodity Stabilization.

55. The pledged contributions to the Fund accounted to US $ 3,435 million at the end of 1984. paid in contributions, on the other hand, totaled US $ 2,513 million. See: the *Annual Report 1984*, OPEC p. 12.

entering a period in which concessional flows for development of the Third World are becoming scarce. Yet the need for them is increasing. The problems of development are now well understood. They have become more severe but they are understood better then even before. There is no disagreement in principle on what the remedies and the policies should be, and there is understanding of the levels of assistance that will be needed within the context of an overall policy that will give an acceptable result in human and economic terms. There is reason for hope in this work. But the challenge is very great."[56]

The OPEC is very clear in its purposes for which the Fund's resources will be utillized; they are:

(a) providing interest-free long term loans to finance balance of payments support and development programmes and projects;

(b) making contributions by the parties to this agreement, to international development agencies the beneficiaries of which are developing countries.[57]

**Concessionality of the OPEC Fund**

Concessionality of any loan is measured in terms of the "*grant element*" of the loan commitments. According to current convention, offical Development Assisatance (ODA) comprises financial flows from official sources that have the promotion of economic development and welfare as their main objective, and that have a *grant element* of at least 25%. The grant element is a percentage of the face value of the loan that is calculated by comparing the present value of the interest payments and repayments of principles with a discount rate of 10%. The grant element is thus increased not only by low rates of interest but by long maturities and grace periods. It is reduced by fees and charges.

The OPEC Fund's customary 1% service charge ranks as interest in the calculation. For the OPEC Fund loans the weighted average grant element for 362 loans committed since the fund started operations is about 51%. Most of these loans have been extended to the low-income countries on concessional terms.[58]

56. The OPEC Annual Report 1984 at p. 35.
57. Article 2.02.
58. *Ibid.*

Net disbursements of concessional assistance provided by OPEC member countries to other developing countries totalled about US $ 74 billion (i.e. 22% of total ODA flows from major donors) in the period between 1973-84.[59]

Thus it would appear that the OPEC Fund and its members have fulfilled their purposes of promoting solidarity among developing countries.[60]

**Other Sources**

(i) *Saudi Fund for Development*

The Saudi Fund for Development (SFD) was drafted by Royal Decree on 1 September 1974. It commenced operation with effect from 1 March 1975.

The basic objective of the SFD is defined as to "*participate in the financing of development projects in developing countries through granting of loans to said countries*". The emphasis according to this is on development projects that promote the social and economic well being of the people in low income countries.[61]

The Saudi Fund for Development Assistance carries high grant element and is untied in procurements. The Fund's activities have no geographical or sectoral limitations. It deals directly with the governments of developing countries and the assistance is provided for development projects. SFD project financing priorities closely follow those selected by the recipient country's governments. By the nature of its regulations, financing facilities are concentrated on the least developed countries and other adversely affected low income countries in Africa, Asia and Latin America.

***Statutory Framework***

SFD Charter also set the basic rules that regulate its operation. Prior to granting a loan, the Fund has to investigate the productivity of the project to be financed, after taking into considered, *inter alia*, the financial standing of the borrowing government with reference to size or loan and adequacy of financial and economic resources that

59. *OPEC Aid and OPEC Aid Institutions: A profile*, 1985, p. 1.
60. *OPEC Annual Report 1984*, p. 55.
61. *The Saudi Fund for Development, Annual Report 1984-85*, p. 7.

ensures its repayment. The Fund also takes into account the availability to the borrowing country of the funds required for the execution of the project in addition to the amount of the loan.

The conditions for the SFD loans are enshrined in Article 7 of the Charter. According to Article 7 the following conditions are to be fulfilled:

(a) that the project to be financed contributes to the economic and social well being of the borrowing country;

(b) that the loan is paid and repaid in Saudi Riyals;

(c) that the amount of loan granted to any project does not exceed five per cent of the total capital of the Fund and fifty per cent of the total cost of the project for which the loan shall be effected;

(d) that total amount of loans granted to any country shall not exceed ten per cent of the Funds capital at any one time.

Within the statutory framework, the Fund designs strategy and frames policies to assist developing countries in achieving their socio-economic objectives. The Fund, however, gives special consideration to the needs of those low income countries that have suffered most on account of international environmental changes and have basic limitations in accomplishing development objectives.

(ii) *Kuwait Fund for Arab Economic Development*

Kuwait, ever since its independence in 1961, has been using a portion of its surplus capital as economic assistance to other Arab countries. Kuwait created Kuwait Fund for Arab Economic Development to participate in the task of development assistance.[62] One of the earliest of its loan was to Sudan with conditions such as that the loan was to be repaid in 16 years with a grace period of 3.7 years with a grant element of 36 per cent. Since then the Kuwait Fund has advanced loan for construction of infrastructure such as railroads, highways, power plants and ports. However, it does not provide balance of payments support or general programme loans, nor does it participate in equity financing. Although its Charter has given it the power to make loan guarantees and to raise capital in

62. For a brief account on this see: Jeswald W. Salacuse *"Arab Capital and Middle Eastern Development Finance"*: *"The Emerging Institutional Framework" in Journal of World Trade Law*, vol. 14, pp. 283-309 at pp. 289-292.

other financial markets or through the issuance of bonds, it has not utilised that facility.[63] The Kuwait Fund is eligible to make loans both to a State or other entities, corporate or otherwise, provided that objectives of such entities are not profit making.[64] When an entity other than the State is provided a loan, then the State has to make guarantee with regard to the loan. The matters that are required to be guaranteed are relating to repayment, foreign exchange, and exemption of fund income and assets from nationalization and taxation. The general features of Kuwait Fund are:

The average length of a loan is from 15 to 25 years with an annual interest rate of 2.5 to 4 per cent depending on the nature of the project, a grace equal to the length of time necessary to implement the project. Interest on agricultural projects are generally at the rate of 3 per cent, while for industrial projects it is 4 per cent. In addition to interest, each loan is subject to a service charge of one and a half percent annually on the amounts withdrawn and outstanding to cover administrative expenses and other costs incurred in the execution of the agreements. In case of exceptionally poor countries, the Fund has made loans at no interest or interest of one to two per cent for periods extending upto 50 years.

## IV. Commercial Loans

Although there are a few well developed forms of loan agreements, the one needs to be studied in the context of the debt burden of developing countries is the loan agreements with transnational banks *i.e.* private commercial banks of the industrialised countries. The recent trend among the transnational banks is to advance loans to sovereign borrowers by the method known as "*syndicated loan*"

### 1. Syndicated Loans: Organisation and Main Features

Syndicated loans take many shapes and forms and come in all sizes.[65] There is no limit either to the amount advanced as loan or to the number of banks who associate themselves in lending a particular loan. The applicants include sovereign States, their central banks,

63. *Ibid*, p. 290.
64. Article 13 of the Charter of Kuwait Fund.
65. Richard Slatter, "The Transnational Law of Syndicated Loans – A Hopeless Cause" in Norbert Horn and M. Schmitthoff *The Transnational Law of International Commercial Transactions*, Kluwer, 1982, pp. 329-352 at p. 330.

international organisations, nationalised industries, multinational corporations, private sector industrial and trading companies, financial institutions, service organisations, joint ventures.[66] However, the syndicated loans are advanced by a *consortia of banks* either situated in USA or England, more particularly New York or London or other financial centres like Paris, Tokyo etc. Before venturing into the standard features of these loans, it would be pertinent to know about certain characteristic features of these *consortia* themselves. From the legal point of view there are at least three features[67] that could be noted among the syndicated loans. *Firstly*, there is no governmental or inter-governmental regulation of these consortia. This means that a bank is not subject to the usual restrictions of banking. Hence the banks that take part, for instance, in Eurodollar market are not subject to critical requirements, such as the reserve that a bank must keep in respect of its operations.[68] *Secondly*, the transactions of inter bank loans and deposits are effected very informally even by a telephone call. Thus when a bank grants a loan, it may use its own resources or borrow from other banks. Although such flexibility enables the banks to meet a large demand quickly, but at the same time, can lead to a situation, where non-compliance by one single bank can endanger the working of the entire system.[69] *Finally*, the European market has its own rules for establishing the London Inter Bank Offered Rate (LIBOR) of interest which fluctuates from time to time.[70]

The lack of regulation of financial centres such as the London market led to a burgeoning of granting of syndicated loans by banks

66. *Ibid;* p. 330
67. Gonzolo Biggs, "*Legal Aspects of the Latin American Public Debt*", *CEPAL Review No.25*, pp. 163-187 at p.171.
68. *Ibid.*
69. This vulnerability became evident during the Mexican crisis of 1982, when six banks – Bancomer, Banamax, Banco, Serfin, Commermex, Somex and Banco International – which had agencies in the London inter bank market, were unable for several days to meet the deposit obligations with other banks. According to one commentator if these accounts had been frozen, the entire inter bank market could have collapsed and the effect in London and probably New York would have been devastating. *Ibid.*
70. This rate represents the amount which a bank operating on the London Inter bank market pays to another bank operating on the same market for a Eurdollar deposit for a term of not longer than one year. LIBOR is determined by the quotation given by the so-called reference banks participating in a loan transaction of a given hour on a contractually pre-established date for determining the applicable interest rates, which is usually paid every three or six months. Thus, LIBOR is ia variable interest rate which fluctuates according to the market in London, The U.S. counter part is known as U.S. prime rate. *Ibid.*

organised in consortia throughout Seventies and Eighties.[71] The emergence of syndicated loans from commercial banks was due to various factors that have been prevailing in the world economy since the Seventies. To mention only a few, decline in the soft loan facility such as International Development Association (IDA), the conditionalities of International Monetary Fund (IMF) and World Bank (WB); availability of reserves in the commercial market and its readiness to lend to credit needy borrowers.[72] Commercial loans, generally required no conditions which permitted developing countries to avoid the economically and politically painful austerity measures which were imposed by other sources such as IMF, World Bank.

There are *two fundamental purposes* behind these consortia loans. *Firstly*, the possibility of mobilising more reserves than any individual bank could loan and *secondly*, the proportionate reduction in the risk to each member in the consortium. With these purposes a consortium is organised through a mandate letter from the loan applicant authorising a bank to act as the *lead manager* bank in forming the *consortium*. At the same time the applicant sends a memorandum giving detailed information on his economic and financial situation. The mandate letter and the information memorandum then enable the lead bank to invite other banks to participate in the formation of a consortium. The consortium establishes a separate legal relationship which is independent of the loan contract between lead bank and the borrower. The consortium is further strengthened by a cross default clause which entitles a creditor to demand payment of the entire balance on the loan whenever the debtor has failed to meet a financial obligation with another creditor. In other words, the consortium requires additional protection which prevents a debtor from choosing to meet only some obligations and not others. The cross default clause prevents him from making this choice and forces him to meet each and every one of his obligations.[73] Thus in the words of Biggs, the consortium, reflects the sophisticated organisational capacity and the institutional solidarity of the banks.[74]

71. For instance more than 60% of the developing countries' external debt is owned to these consortia. As of 1987, out of total long term debt of $847 billion, $558 billions are owed to the commercial banks. See the International Debt situation in mid 1987, Report of the Secretary-General A/42/523, 16 September 1987, p. 9-10.
72. See also *Doc. No. AALCC/XXV/9*, p. 9, 10.
73. For a detailed information on cross default clause, see *Infra*.
74. G. Biggs, *op. cit.* n 69, p. 172.

## 2. Principal Clauses

Although variation may exist among loan agreements, they tend to comprise a standard collection of clauses. The syndicated loans are generally drafted in standard language reflecting the many years of experience of the banks working in this field. Hence it is possible to identify the primary parts of a loan agrement. They are: Preamble; business terms and conditions; change of circumstances; representations and warranties; positive (*Pari pasu*) and negative covenants; events of default clause; applicable law and jurisdiction; sovereign immunity. There may, however, be other clauses relating to minor issues of the agreements.

*Preamble*

The section relating to preamble addresses the issues of parties to the agreement; purpose of borrowing and the definitions of key terms. The most important aspect of this clause is the article on definitions since it can play a significant role in avoiding confusion as to the meaning or intent of the language or terms used in the agreements. This part also serves to highlight and clarify terms of specific significance which appear throughout the contract. However, there are problems relating to this section. For instance, a seemingly acceptable clause in the body of the contract can undergo a radical change in meaning as the result of its association with previously ill-defined terms.[75]

Such a contingency underlines the need to analyse definitions carefully before setting them down, because a word which may seem inconsequential could, under certain circumstances, become detrimental to the borrower or impose excessive obligations on him. However, it must be emphasized that not every term in the agreement should be defined, but only those for which definitions are considered by both borrower and lender as essential in order to render the interpretation of pivotal provisions clear and unequivocal.

*Business terms and conditions*

This part of the loan agreement spells out the financial obligations of the borrower to the lender, such as interest rate, commitment fees,

75. Guillermo Solivan, "Some issues in the negotiation of Commercial Foreign Exchange Loans in Developing Countries" in *Issues in Negotiating International Loan Agreements with Transnational Banks*" op. cit, p. 9.

penalities, amortization and related arrangement such as time, place of payments etc.[76] Here, the borrower should be fully aware of every problem relating to these issues.

*Changes in Circumstances*

Syndicated loan agreements invariably contain a number of yield protection[77] and other changes in circumstances clauses. These clauses cover the procedures to be followed in the event of contingencies that stem from the method used to found Eurocurrency loans, such as the unavailability of the loan currency in the market from which the loan is funded, increased costs of funding the loans due to developments such as new reserve requirements and taxes, inability to determine the interest rate on the basis set forth in the agreement, and other kind of catastrophes.[78] In other words, the banks seek to write into loan agreements a provision allowing them to adjust the terms of their loans in accordance with any changes which may occur in the market, covering even extreme changes that seem most unlikely to occur.

The clause relating to changes in circumstances is basically meant to protect the lender hence this is not an area where a borrower can expect to obtain significant concessions from its lender.[79] There are certain legitimate cases of change in circumstances, which a borrower might accept, such as illegality, increased costs, non-quotation of interest rates (market collapse).[80] There are few areas, however, where lenders have shown a bit flexibility.[81] The consequences of the

76. For detailed illustrations, *ibid*, pp. 11-13.
77. Every agreement contains provisions protecting the lender against increased costs and erosion of its return due to changes in law or government policies. The first part of this protection is a provision requiring the borrower to make all payments without withholding for taxes and other levies imposed by the borrower's government (or by the borrower itself if the borrower is a government). This kind of provision is often contained in what is called a "withholding tax clause". A withholding tax clause is usually accompanied by a representation that no withholding tax or levy exists at the time of the execution of the loan agreement. The second kind of yield protection provision found in the agreements was a clause providing that the borrower would reimburse the lender in the event that a change of application in law such as the new reserve requirement, increases the lenders' cost of making or maintaining the loan. This kind of provision is often found in what is called an "*increased costs clause*" or a "*reserve requirement clause*"
78. Lester Nurick, "Negotiation of Transnational Bank Loan Agreement entered into by Developing Country Borrowers: Legal and Other Issues" in *Issues in Negotiating International Loan Agreements with Transnational Banks*, p. 49.
79. *Ibid*.
80. For further information see Jose Angel Curria Trevino *op. cit.* No. 11, p. 40.
81. Lester Nurick *op cit.*, No. 80 pp. 49-53.

presence of this clause is that the borrower should be able to repay the loan when the lender invokes this clause. Thus, the repayment of the loan is in accordance with the perceptions of the lender and not of the borrower as far as the changes in circumstances are concerned.

*Representation and Warranties*

The loan agreements generally contain a typical clause relating to what is known as *representation* and *warranties*. The representations and warranties are given by a borrower. *Representations* are statements made, and *warranties* are assurances given by the borrower and they form the basis on which the lender makes the credit available.[82] They are collectively known as "*declarations*".

The declarations under this clause could be classified broadly under two heads: *legal warranties*, and *commercial and financial warranties*. The former are generally in regard to the due establishment or organisation of the borrower; its authority to engage in business and to enter into borrowing arrangements; the absence of any contravention of its charter or consstitution and aplicable law and regulations and other agreements to which the borrower is a party; the obtaining of all governmental licenses and approvals for the performance of the loan agreement and material ancillary agreements; and validity and binding nature of the loan agreement. Commercial and financial warranties include the borrower's financial condition, business operation and contingent liabilities as well as title to assets, any material litigation and disputes in which the borrower may be involved, the absence of defaults under the loan agreement, encumberances on the borrower's assets and the like.[83] However, soverign borrowers' will not be required to give warranties as to their precise financial condition at a given date, since there is no balance sheet relating to the country as a whole to which specific reference can be made. On the other hand, the information memorandum may contain some statistics.[84] There are special warranties in the case of a soverign borrower.[85] They are of the following nature :

82. K. Venkatchari, "The Eurocurrency Loan: Role and Content of the Contact" in Lars Kalderen and Qamar Siddiqi (ed.) *op. cit.* No. 4, pp. 86-91 at p. 86

83. However, Philip Wood has given detailed information relating to warranties; see Philip Wood "*Law and Practice of International Finance*" (Sweet & Maxwell, London, 1982) pp. 242-243 quoted by Venkatachari n. 4.



1. The borrower is subject to civil and commercial law with respect to its obligations under the agreement;
2. The borrowings by the borrower under the agreement and the execution, delivery and performance of the agreement by the borrower constitute private and commercial acts.
3. Neither the borrower nor any of its revenues or assets enjoy any right of immunity from setoff, suit or execution in respect of its obligations under the agreement, same as may be extended by any competent court in respect of commercial transactions by a sovereign State;
4. The waivers by the borrower contained in the agreement of any right or immunity are irrevocably binding on the borrower. Warranties of this kind seek to ensure that the sovereign borrower will be stopped from pleading that it is an independent and autonomous sovereign or State and that the various provisions in the agreement relating to its borrowing and agreement on the governing law, and jurisdiction of the chosen fora are not binding because of its immunity from suit, setoff attachment, execution etc.[86]

It is said that the representations and warranties should be correct not only at the time when the loan agreement is signed but throughout the term of the agreement. The *continued correctness* is a condition precedent where the loan is to be drawn in instalments. However, it is advisable on the part of the borrower to be alert and vigilant since it is possible that sometimes agreements are patently unreasonable. Thus, there are several issues and instances wherein the borrower might be compelled to make vague representations which are likely to endanger the borrower's interests. Hence as a precaution, the borrower should try to negotiate those representations which deal only with matters which are material to the loan.

The clauses relating to representations and warranties, if carefully examined, would show that it puts restrictions on the sovereign activities of the borrower. The representations and warranties are statements of facts relating to legal, financial and commercial matters which are expected to remain there not only at the time of the loan,

84. Qamar S. Siddiqi "Some critical Issues in Negotiations and Legal Drafting" in Lars Kalderen and Qamar Siddiqi *op. cip*. p. 56.

85. Venkatachari *op. cit.* n. 4, p. 90.

86 For a detailed examination of this concept see *Infra.*

but also throughout the period. A pertinent question would arise in this regard. Supposing a loan's life is twenty years, does it mean that the statements made at the time of loan should remain throughout those 20 years? Would the borrower, in the capacity as a sovereign, not be able to affect any policy changes in its domestic scene that may put the facts relating to juridical, commercial financial aspects to vary with the original statements made in the loan agreement. Thus the effect of representation and warranties as interpreted by the lenders is not only unrealistic but also against the very functioning of the sovereign itself. Hence the borrowers should be able to persuade that this clause should deal only with the facts relating to loan under negotiations and not the whole country (sovereign) as such.

*Positive and Negative Convenants*

This chapter deals with the promises or undertakings by the borrower to perform or to refrain from committing certain acts which would affect his financial condition and integrity. In other words, it is a way of ensuring the continued soundness of the credit. The covenants also ensure the lender to have some inside information on and control over the business of the borrower.[87]

There are positive and negative convenants. Under a positive covenant the borrower is expected to use the credit for the specific purpose of the agreement, submit financial statements on a regular basis, maintain proper records and give periodic assurance that the borrower is maintaining terms of the agreement and that all applicable licences remain in force throughout the life of the loan.[88]

One of the usual convenants that appear in syndicated loan is the *pari passu* clause. The *pari passu* covenant is an undertaking by the borrower that a particular loan will rank equally with others in terms of priority of obligations.[89] In other words, the *pari passu* clause contains an obligation on the borrower to maintain parity between its unsecured obligations. In fact, it Precludes a sovereign borrower from giving preference to certain creditors by, for instance, giving from first bit reserves or its revenues.[90]

87. Venkatachri n. 4, p. 91.
88. Gullermo Solviven n. 77 p. 19.
89. Venkatachari, n. 4, p. 91.
90. *Ibid.* p. 92.

The negative pledge clause is different in purpose. whilst the *pari passu* clause seeks to maintain parity between the borrowers'; obligations, the negative pledge clause seeks to control the borrowers ability to create or maintain secured indebtedness subsequently. Its main function is to ensure that the present and expected assets of the borrower will still be available for satisfying any outstanding claims of the lender in the event of the borrowers' default.[91] Although the inclusion of *pari passu* and negative pledge clauses in transnational loan agreements is understandable for various reasons, the question for the borrowers to consider is the significance of the particular provisions in these clauses and whether they should try to negotiate on the points involved. The borrower in this regard should think about the undesirable consequences of poorly drafted or negotiated clauses on this point.[92]

The clause relating to positive and negative pledges could actually curtail the freedom of a borrower with regard to its future borrowing from other borrowers. Given the fact that there are several key terms and phrases that are used in this clause, the borrowers must be extremely careful whenever negotiating this clause.

*Events of Default Clauses*

The provisions relating to the events of default or "*declaration of maturity*" section is more intensely negotiated in a transnational loan agreement. It is generally viewed to have evolved against the interests of borrowers over years.[93] The overall purpose of event of default clause is to enable lenders for repayment of the loan in appropriate circumstances before the original date for payment.[94] However, the main problem in default clauses is what constitute a real threat to lenders and what circumstances or events are appropriate for demanding repayments.[95] However, it is standard practice to assume that an event of default has occured *inter alia* if (a) the borrower fails to pay amounts due under the agreement, (b) the borrower's failure to comply with any obligation under the agreement, (c) any material representation or warranty made in the agreement proves to be incorrect, (d) if the borrower becomes (if not the

91. Payul I Barris, "Negative Pledge" in Lars Kalderen and Qamar S. Siddiqui (ed.) at p. 156.
92. For such consequences see Lester Nurick *op. cit* n 80, p. 54.
93. Jose Angel Ourria Trevino n. 6, p. 4
94. Richard G.A. Youard, "*Events of default*" in Lar Kalderan and Qamar Siddique, (ed.) p. 177.
95. *Ibid.*