Non-Recourse Lending to Cross-Border Infrastructure Undertakings: Indian Credit's Lost Opportunity?

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Abstract

One of the main distinctions of debt finance for infrastructure ventures (i.e., syndicate lending by banking institutions for specific project development) from generic corporate undertakings (i.e., debenture issues financing expansionary productive factor acquisition) is the scope for obtaining such leverage on *Non-Recourse/Limited-Recourse terms*, exclusively characteristic of infrastructure ventures.[i] The term *Recourse* in this context, implies the ability to create and enforce security interest (loan collateral) directly from the assets of the *Sponsor* (proprietor/originator)[ii] of the infrastructure undertaking, by prospective lenders. *Non-Recourse* or *Limited Recourse* lending[iii], would hence amount to the blanket inability of lenders to directly collateralize the assets of the *Sponsor* (however subject to potential exceptional allowances stipulated as consequences of breach of underlying debt contract covenants).

Keywords: Infrastructure Sector, Project Debt Finance, Special Purpose Vehicles, Cross-Border Sponsorship, Debt Structuring, Ring-Fencing

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Non-Recourse Financing Explained

The method of achieving such *Non/Limited-Recourse* transaction character, is strategic *Ring Fencing*:[iv] being the use of Special Purpose Vehicles (**SPV's**)- corporate intermediaries (bearing separate legal personality-as either wholly owned subsidiaries/affiliates of the *Sponsor*), for the direct holding of the infrastructure undertaking. The separate legal personality (and resultant distinction of asset patrimony) of holding companies and their subsidiaries- bearing the *Lex Generalis* effect of non-derogable asset partitioning, was sanctified by the Supreme Court in ¶ 105 of *Vodafone International Holdings BV v. Union of India*[v]**;** while ¶ 277 upheld the *Lex Specialis* circumstance of fraudulent incongruity between transaction form and economic substance- to warrant exceptional corporate veil piercing. Hence, the incorporation and use of intermediary SPV's, to hold infrastructure undertakings- protects *Sponsors* from direct liability claims/charge creation by lenders: with SPV's directly obtaining the entirety of the requisite leverage from creditors, upon collateralizing the assets of the infrastructure undertaking- as held. Additionally, only the proceeds of the SPV (generated after the project gestation period[vi]), would be utilized for the payment of debt service cost (interest owed to lenders) and the ultimate repayment of any loans obtained for the project, even as accelerated[vii] upon event of default. The modus of an Indian SPV is hence formative to the structuring of *Non-Recourse* lending, to infrastructure undertakings by Indian/Foreign Sponsors. While the Prima Facie allowance of *Ring Fencing* via SPV's, may be prematurely perceived as the Central Government's incentivization of over-all project sponsorship in the economy- the actual benefit of any such offerings, may be *solely enjoyed by domestic sponsors* (excluding cross border sponsorship)- significantly limiting the borrower market access of Indian infrastructure lenders, due to the adversity of Indian government and Reserve Bank (**RBI**) regulatory impetus as explained in this article.

Specifics of Indian Cross-Border Project Sponsorship Regulation

With the 12 January 2024- proclamation[viii] by BlackRock of it's intended acquisition of Global Infrastructure Partners- for consideration in cash (3 billion USD) and kind (asset swap of BlackRock common stock in exchange for GIP shareholding): Private Equity's newfound enthusiasm in sponsoring multi-national infrastructure undertakings, *remedying government*

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deficits can be perceived. Such a proactive direction of capital towards infrastructure sponsorship- by Private Equity, creates an invaluable opportunity for Indian banking institutions, to develop long-term infrastructure asset portfolio's- assuring surplus from large scale public venture commercialization. The incentive of *Non-Recourse* loan structuring- by domestic Indian lenders in pursuit of such opportunity, however cannot be offered to Foreign Sponsors due to the Foreign Exchange Management (Non Debt Instrument) Rules 2019 (**NDI Rules 2019**)[ix] and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2017 (**RBI Regulations 2017**)[x]. While Regulation 14: 5 (b) of the RBI Regulations 2017 initially codified an express prohibition upon the ability of SPV's (being wholly owned and controlled by foreign investors in their capital instruments)- to obtain leverage from Indian domestic banks, for the pursuit of downstream investment; Rule 23 of the NDI Rules 2019- embodies the contemporary position[xi]. The Explanation to Rule 23: Clauses (g) and (i), classify the cross-border sponsorship of Indian infrastructure-undertakings as downstream and indirect foreign investment. The acquisition of Indian capital assets by an Indian entity (subject to total foreign investment i.e., an Indian SPV) is downstream investment. Indirect foreign investment- is downstream Indian capital asset investment originating from non-residents (outside India)- and being channelled through wholly owned and controlled Indian entities/investment vehicles. An express prohibition on the ability of such intermediary Indian entities/investment vehicles operating at the behest of non-resident investors, from being financed through domestic Indian credit- is codified in Rule 23 (4) (b) of the NDI Rules 2019. The source of capital for such intermediary Indian entities/investment vehicles undertaking capital asset acquisition/establishment is expressly restricted to *Internal Accruals* (surplus profit after tax) and *Foreign-Sourced Funding*. Hence, the opportunity window for domestic Indian credit to capitalize upon the prospective pervasion of cross-border infrastructure undertakings in India[xii] (by offering *Non-Recourse* financing incentives), while creating self-sustaining non-current asset portfolio's (assuring surplus overtime- due to Indian consumer base scale)- *is currently closed by the Central Government and the RBI.*

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Way Forward

The amendment of Rule 23 (4) (b) of the NDI Rules 2019: eradicating the obstacle of domestic credit inaccessibility for downstream cross-border sponsorship of Indian infrastructure, is long overdue in the year 2024 for the alignment of foreign investment regulation with the Viksit Bharat 2047[xiii] policy objective, contingent on optimized infrastructure investment- *without worsening fiscal deficit*. The Interim Budget 2024[xiv], entailed the affirmation of INR 11.11 Lakh Crores- being allocated to infrastructure investment (with specialized outlays of INR 2.72 and 2.52 Lakh Crores for Roads and Railways- formative of transport infrastructure). *India however is devoid of fiscal surplus*- with the recent computation of fiscal deficit for the first 7 months of FY2023-24: as 96.86 billion USD.[xv] With the *absence of fiscal surplus*, the achievement of the assured infrastructure investment, may be optimized with the *government's proactive incentivization of foreign capital infusion* (via downstream SPV intermediaries- providing sponsors with *Non-Recourse* borrowing options). Strategic private credit and bank lending mobilization is just the start of the prospective implication of amending Rule 23 (4) (b)- with the ultimate result of empowering: *downstream cross-border Leveraged Buyouts* (**LBO's**) of Indian capital assets (via intermediary SPV's)- exponentially increasing debt finance opportunities for Indian Mergers and Acquisitions. LBO's via domestic credit were originally prohibited- by the RBI, in it's 1998 Master Circular[xvi] (¶ 8)- eliminating the option of obtaining domestic bank leverage for the acquisition of another company's equity shareholding/control by promoter interests. Both cross-border LBO's and downstream infrastructure investment are gaining mainstream-popularity[xvii] as avenues for channelling non-recourse bank leverage and private credit- for the creation of self-sustaining and profitable non-current asset portfolios. Indian credit should not be restricted from offering non-recourse financing- auxiliary to foreign indirect downstream infrastructure investment; due to the potential slippery slope fallacy of triggering obstacles to the government's achievement of Viksit Bharat 2047. *Regulatory evolution*– via the allowance of non-recourse financing by domestic credit to Indian intermediary SPV's (wholly owned and controlled by foreign Sponsors) is hence justified.

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Endnotes

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