First Demand Guarantee and Project Finance

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The structuring of long-term financing in the form of Project Finance ("Long-Term Financing") requires a significant amount of time, as it is necessary, among others, to (i) define the best structure (i.e., level of leverage, use of debentures or a financing agreement, etc.) and (ii) negotiate all terms and conditions of the financing agreement (or debentures) and the respective guarantees.

In addition, once all the foregoing documents have been agreed and signed, usually several conditions precedent must still be fulfilled for the lender to make the first disbursement to the company that will develop the infrastructure project ("Project Company").

It turns out that the Project Company has a deadline to complete the project and therefore, the company cannot start construction only after receiving resources under the Long-Term Financing.

Thus, in order to obtain resources in order to start the construction of the project as quickly as possible, the Project Company normally resorts to a bridge loan that provides it with resources immediately and that will be paid with the resources from the Long-Term Financing.

The bridge loan will normally not benefit from the Long-Term Financing guarantees and will therefore have a very high cost, in particular with respect to interest rates. One way that could be used by the sponsor to decrease such a cost would be a guarantee with the maximum possible liquidity. At first glance, the bank guarantee always appears as the most appropriate guarantee, despite its high cost.

In this context, an alternative that should be better analyzed and applied in Brazil would be the first demand guarantee ("FDG"), through which the lender of the bridge loan may require the payment of a certain amount to the issuer of the FDG (in this case, we will assume that it is the sponsor), provided that the terms set forth in the FDG are met (usually a simple communication from the lender indicating the existence of default by the Project Company of any payment obligation under the bridge loan).

The great advantage of FDG is that it is an autonomous and independent guarantee of the underlying obligation, and thus, the sponsor could not question the validity of the payment requirement made by the creditor, either by personal exceptions of the Project Company and/or the sponsor, or for issues related to the bridge loan contract, except in cases of fraud. If the creditor requires the payment of the FDG in disagreement with the terms thereof, any questioning (except with respect to fraud) must be judicially analyzed ex post, that is, after payment and the consequent receipt of funds by the creditor. This situation is perfectly reflected in the adage solve et repeates ("pay first and complain later"). Thus, the execution of the FDG and the consequent payment to the creditor will occur more safely and quickly.

Unfortunately, in Brazil, FDG is rarely used, given the lack of legal provision expressed in our legal system and the consequent fear of the creditor of not being able to execute it quickly.

However, we understand that the FDG can be reconciled with our legal system, based on the principle of autonomy of will, as a unilateral, atypical and non-accessory guarantee contract (unlike a corporate guarantee). Therefore, nothing should prevent the creditor and the Project Company from being creative and using this type of guarantee. All this, of course, without prejudice to the urgent need for specific regulation for FDG, in order to give it even more legal certainty for all parties involved.

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