OFFICE MEMORANDUM

DATE: January 29, 1997

TO: Mr. Richard E. Bissell, Chairman, Inspection Panel

FROM: Andres Rigo, Acting Senior Vice President and General Counsel

EXTENSION: 81782

SUBJECT: BANGLADESH - Jute Sector Adjustment Credit (Cr. 2567-BD)
         Request for Inspection
         Legal Opinion

1. In your memorandum of January 16, 1997 to Mr. Ibrahim Shihata, you requested advice concerning various remedies available to IDA under sector adjustment credits in certain situations set out in the memorandum. First, I explain briefly the contractual arrangements for adjustment operations and then reply to your specific questions.

2. The agreements for adjustment operations are different from those for investment operations in several significant ways. First, by contrast to investment credit agreements which contain covenants covering the borrower’s contractual undertakings in respect of the execution of the project, there is no covenant obliging the borrower to carry out the program of adjustment measures supported by IDA through a credit. This program is described in a letter of development policy which is furnished by the member country to IDA and on the basis of which IDA makes the credit available to the borrower. Second, the financing provided is generally intended as balance of payments support. Originally, it was provided for the financing of imports, as in the case of Cr. 2567 BD, but more recently, the funds are simply transferred to the central bank of the borrower and they may be used for imports or retained as reserves. Third, because the funds are intended to be disbursed fast, the credits are usually tranched and sets of conditions are linked to the disbursement of each tranche so that there is a certain parallelism between progress in the reforms and the disbursement of the funds. On occasion, single tranche operations have been made.

3. Against this general background I proceed to reply to your questions about what remedies, aside from withholding the release of outstanding tranches, are available to IDA:

   (a) "when the Borrower... does not comply with the conditions established for the release of one or more tranches;"

   If the borrower fails to take the actions specified for tranche release:
(i) IDA is not obliged to disburse any of the proceeds of the credit to the borrower; and

(ii) if IDA determines that such failure amounts to a situation which shall make it improbable that the reform program or a significant part thereof will be carried out, it may, pursuant to the relevant provision in the Development Credit Agreement\(^1\) suspend in part or in full the right of the borrower to withdraw the proceeds of the credit and 30 days later cancel the amounts so suspended if the borrower has not taken any action to remedy the situation\(^2\). If this option is followed, IDA may, under Section 6.02 (c)(i)\(^3\) of the General Conditions suspend all other credits to Bangladesh\(^4\); or

(iii) by the expected date for compliance normally provided for in the letter of development policy, IDA would review the situation, including undertaking supervision missions, and may, after that, give notice specifying the actions that should be carried out within 90 days. If the borrower fails to do so by that date, IDA may cancel the undisbursed amount of the credit\(^5\).

(b) "after having complied with such conditions [the Borrower] takes actions that are not consistent with the reform program supported by the credit and – legally or in practice – would amend, adversely affect or leave without effect the actions taken to meet the conditions which were the basis of IDA’s prior tranche releases".

Once the borrower has taken the actions necessary for tranche release, it is notified of the decision of IDA that it is entitled to withdraw the proceeds of the tranche concerned. If between the giving of such notice and the full disbursement of the tranche, the borrower takes actions inconsistent with the reform program, the right described in paragraph 3 (a) (ii) above is available to IDA. If these actions occur after all the proceeds of the credit have been withdrawn, the right to suspend would not be available as a remedy under the Development Credit Agreement.

---

1 Section 4.01 of the Development Credit Agreement (Cr. 2567 BD).
2 Section 6.03 of the General Conditions.
3 Section 6.02 (c)(i) provides: "the Association or the Bank shall have suspended in whole or in part the right of the Borrower to make withdrawals under any development credit agreement with the Association or any loan agreement with the Bank because of a failure by the Borrower to perform any of its obligations under such agreement".
4 Neither IDA nor the Bank has exercised this right except in situations of default under the borrower’s payment obligations.
5 Paragraph 5 of Schedule 1 to the Development Credit Agreement for Cr. 2567 BD.
Relatively recently a new clause has been included in all development credit agreements for adjustment operations requiring the borrower to “exchange views with the Association on any proposed action to be taken after disbursement of the Credit which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program”, including any action specified as a condition of tranche release. If the borrower would proceed to take such action without exchanging views with IDA, then IDA could, after a 60-day notice, accelerate the maturity of the credit under Section 7.01(c) of the General Conditions. Credit 2567 BD precedes the introduction of this clause as a regular requirement for adjustment operations.

(c) “[the Borrower] takes no action, or at least not sufficient action, to carry out the reform program or meet the conditions for the release of pending tranches within the dates or timetable envisaged in the reform program.”

In the final scenario indicated in your memorandum, the remedies described under paragraph 3 (a) above are applicable depending on the circumstances of the case.

4. It should be noted that the remedies available to IDA constitute contractual rights which IDA is entitled to exercise and not legal obligations that IDA must perform. Section 6.02 of the General Conditions Applicable to Development Credit Agreements (January 1985), which are an integral part of each development credit agreement, provides that if any of the enumerated events of suspension shall have occurred and be continuing, IDA may, by notice to the borrower, suspend in whole or in part the right of the borrower to make withdrawals from the credit account. Section 6.03 of the General Conditions similarly provides that, under certain specified circumstances, IDA may, by notice to the borrower, terminate the right of the borrower to make withdrawals with respect to certain amounts of the credit. Accordingly, IDA is not legally obliged to exercise any right it may have to suspend disbursements under a credit. The exercise of such right is a matter for IDA’s judgment, taking into account all the circumstances of each case. IDA’s decision in this as in other respects must be guided by IDA’s purposes outlined in its Articles of Agreement and by its interests and the interests of its members as a whole.

---

Section 7.01 (c) provides: “A default shall occur in the performance of any other obligation on the part of the Borrower under the Development Credit Agreement, and such default shall continue for a period of sixty days after notice thereof shall have been given by the Association to the Borrower”.