MERIDIAM RESPONSE TO THE CONSULTATION ON THE TERMS OF PUBLIC SECTOR EQUITY PARTICIPATION IN PF2 PROJECTS

Introduction to Meridiam

Meridiam Infrastructure Managers ("MIM") manages three international PPP funds making investments in greenfield PPP projects in OECD countries, with in the region of £2.5bn funds under management. Meridiam is one of the largest global PPP fund managers with a team of over 50 highly experienced individuals. These funds are long term – 25 years maturity – investment funds and MIM funds are managed on a 'take and hold' basis developing projects from the bid phase either as an independent development entity or as part of a consortium, investing from the outset of construction and remaining with the project during the operational period.

The majority of these funds are provided by both public and private sector pension funds who have invested in the MIM funds in order to promote long term investment thereby matching their liabilities to infrastructure assets that have a low correlation to general economic trends and stable, defensive cash flows.

Meridiam has been involved in the creation and development of infrastructure projects in excess of £15bn, and through its subsidiary, Fulcrum Infrastructure, is highly active in the UK's LIFT programme with over £450m of total investment. Meridiam also has a number of other greenfield investments in the UK such as the Nottingham Tram, the University of Hertfordshire Student Accommodation, Isle of Wight Roads and has most recently secured a preferred bidder position on the M8 roads bundle project in Scotland. In addition, Meridiam has made investments in a further 20 PPP schemes worldwide, including extensively in North America.

General statement of support

In general terms, Meridiam welcomes the incorporation of public sector equity into PF2 projects. Promotion of partnership, building of trust and clear transparency relating to investment decisions between the public and private sector are all elements of infrastructure investment that we support strongly and mobilisation of public sector equity into PPP projects can be a useful element in such partnerships. For example Meridiam, through its UK based Fulcrum Infrastructure Group, has had an extremely positive experience in respect of the NHS LIFT programme that incorporates both public and private sector equity investment and believes that LIFT provides an excellent paradigm.

Size of potential equity marketplace given public announcements

In the context of public announcements that not much more that £5bn total project size will be launched onto the PF2 market over the next five years, we strongly believe that precedent structures such as the LIFT programme should be followed as the creation of new and complex structures will lead only to delay and potentially greater cost and lower value for money outcomes.

As a broad quantification, given the value of total projects to be launched over this period, public sector equity over this five year period might not be greater than £100m or some £20m per annum spread across a number of smaller sized projects. With complex new structures, advisory costs alone are likely to be substantial and simplicity in development, certainty in outcome and a wide use of established precedents with perhaps minor 'tweaking' are to be commended.

Responses to consultation questions:

1. **Please give your observations on the proposed investment appraisal and due diligence arrangements**.

Nature of the investment appraisal:

The proposed investment appraisal process is in itself not hugely onerous, and as long as the information was provided in general terms this should be acceptable. However it should be noted that this appraisal data will be submitted prior to the determination of a preferred bidder. The material will be highly confidential and likely to change just prior to the bid submission – this may also include risk allocation and re-pricing – consequently this is not likely to be a detailed but rather a very general source of information. The final review from the Treasury should recognise the basis on which the bid was awarded, and also not include any fundamental changes that may have an impact on the competitive process. The costs of the detailed legal due diligence – some of which may be very substantial should also be factored in. Reliance documents are not easy to secure.

Requirement for clarity from the outset:

The proposed level of uncertainty is a matter of concern – where public sector equity has, in our opinion, proved to be most effective is as part of a programme where the objectives and expectations are laid out clearly at the outset. If there is no obligation for the public sector to engage from the outset then time and effort will have been taken by the private sector to provide detailed information, to explain their approach and this may just be a nugatory activity. This is not likely to attract private sector bidders to PF2 projects or result in pricing significantly higher than would otherwise be the case as this nugatory activity is priced in.

Alternatively, public sector investment on a programme rather than individual project basis has enabled replication of approach and clear understanding of the structures and objectives of all parties. As a minimum it should be stated from the outset that public sector equity will be utilised or not and to what extent.

Bids are carefully structured, and the prospect of the public sector pulling out at the last minute and leaving a hole for the private sector to fill will all the attendant collateral impacts or alternatively private sector investors looking to put together a fully financed bid, and then having to advise investors that their services will not be needed will not endear the PF2 process to investors to say the least. Uncertainty is likely to cause delay and higher cost and therefore wholly at odds with one of the rationales behind PF2 which was to reduce the time it will take to close projects.

2. **Do you think that the informal public sector equity guidance arrangements during procurement will be of benefit to bidders?**

It is not very clear what these guidance arrangements are – any guidance may assist inexperienced equity investors with general information. Would there be a conflict of interest if guidance is being provided to certain bidders and not all? Could this informal guidance cause bidders to price risks in different ways as part of their bid? Guidance is not a substitute for a clear statement of intentions of the public sector from the outset.

3. Do you have any objections to disclosure of the Transparency Information?

In general terms, we have no objection to the disclosure of this information.

We would suggest however that such disclosures are aligned in content and timing to any information being provided to other funders to keep costs to a minimum. The construction period and operation period should also be treated differently in terms of the periodicity of provision of information. Once a project is up and running data becomes fairly standard.

Clarity on utilisation of this material is critical. If, as a shareholder, the public sector requires operating data relating to its investment that is perfectly understandable – if instead it is just acquiring a volume of information to be collated for no clear purpose there seems little point in its provision.

A more effective approach:

Agree on a financial model from the outset, and check and advise on a quarterly basis against variances to such a model.

Specific comment on Transparency Information required:

- i) A2 and A6 will provide similar information – should be combined although we would point out that it is important to clarify the difference between Directors Fees (i.e. sums being paid to employing companies for the work undertaken by directors and payments directly to directors – we have had specific experience of confusion here
- ii) A8 will also appear in the cash flow statements – combined – it is more practical to have the same frequency of information flow as the management accounts and less time consuming
- iii) During the operating period over 25 years, quarterly cash flows will not vary hugely – these should perhaps go to half yearly with significant variances being reported on a quarterly basis as above
- iv) Under B1 – are you not looking for shares and shareholder debt to be stapled in which case they would have the same beneficial owner – we believe that this is the preferential route for clarity although we have seen instances where the public sector has wished to invest in subordinated debt and thus the instruments are not stapled however we have not had this experience with the private sector?
- v) B3 – does this imply any restriction over sale of shares, if, for example, the public sector did not like either the identity of the purchaser or the price being paid would there be some power of veto – clarification would be helpful?

4. **What are your views on the following arrangements to promote new equity investors?**
    a. **Equity funding competitions post appointment of preferred bidder?**
    b. **Reduction in HMT equity post financial close (either during the Lock In Period or thereafter/)**

Whilst the new proposals have addressed some of our initially stated concerns about the public sector orchestrating equity competitions and bidders being forced upon the private sector preferred bidder, we still remain concerned about the negative impact of such competitions.

To start with, the volume of potential PF2 equity for competition is likely to be limited with some £25-20m per annum to be competed over a number of projects. This is not the volume of investment that would be of any interest to major institutional investors.

One of the aims of public private partnerships is to inject private sector management into project companies delivering assets and to offer a whole life costing approach, managed by long term investors in an SPV. The introduction of equity competitions will not only diffuse this aim but risks wiping it out altogether and instead, categorizing the provision of equity as a purely financial activity rather than as a capital participation bringing enhanced delivery efficiency and focus. In addition, a potential exit by HMTCo from equity participation then there would appear to be no party with a continuing interest in the whole life of the project and delivering service value – this 'churning' has in the past been viewed negatively by public sector clients who wish to see stability in deliverability and personnel.

We believe that the improvements you are considering to simplify and standardise the one time bidding process should be adequate in securing the best possible price from competitors and remove excessive returns, an issue we know that has exercised you for some time. We also feel that if there is a subsequent bidding competition, then there is little interest in first round bidders looking at a most competitive bid. Having a further competition will potentially bring in non-aligned investors who are effectively competing for another role – that of a subsidiary party who are securing a risk position at a different, and potentially higher, rate of return. Higher as the amounts involved appear to be small and a risk premium for participating – if indeed there would be any participants – would likely be a feature.

We believe strongly that investors in projects should bid on a pari passu basis from the outset.

If HMTCo wishes to reduce its equity post or during the Lock-In Period, the question may be raised as to why that equity was injected in the first place. If to ensure a good relationship between public and private investors, it would appear appropriate that the public sector equity were held for the duration of the project – if to just provide liquidity this is simply not necessary as there is substantial availability of equity in the market place specifically targeted at both greenfield, and particularly for brownfield, PPP projects.

5. Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer?

We promote simplicity in capital structure, and believe that investors in a company should have very similar responsibilities to ensure alignment. We do not believe that developers and third party equity should be differentiated in any way, and to the extent that public sector equity providers invest in projects that they should be pari passu with other investors. It is our experience, especially in LIFT projects, that this promotes alignment between investors and a collective responsibility to the resolution of problems.

Indeed there have been issues in LIFTcos where initial funding was provided by the shareholders expecting pipeline of schemes to be delivered in a set time. When the procurement was delayed the private sector partner was expected to provide the working capital. This was not an attractive option when there was no certainty of repayment – schemes were often delayed - and resulted in an unwillingness to provide unlimited working capital with no conclusive funding time frame set. No parties objectives were met and this was a cause of major frustration and conflict. We strongly believe it is far better if all shareholders are aligned.

Working capital facilities should be provided to the SPV as required on a case by case basis as part of the package of project finance facilities. The shareholders in the company purchase shares or invest in subordinated debt on the basis of information provided at the outset in the form of documentation and a financial model. This should take into account the level of working capital required by the company to carry out its activities over time. We have seen cases where only certain investors provide contingent equity, but this involves, if it is drawn, a complex recalibration of returns and additional fees or returns paid to such providers.

6. Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?

We support the stapling of shares and loan stock. We believe that both represent an equity interest in a project of similar risk in projects that should be retained together over time. We do not believe that mezzanine loans should be similarly stapled as they represent a different risk profile.

7. What are your views on the pre-emption provisions?

This appears to be standard to us – if we have a concern it is within transfers within the public sector where we would expect shares to be transferred to entities of the same substance as the initial shareholder – and not simply to any public sector entity and certainly not to one who was in dispute in any way with the SPV.

8. Do you agree with the event of default and deemed transfer provisions?

There is a wider definition of 'Defaulting Shareholder' than we would normally expect to see in that such a definition would apply to the disposal of such Shareholder's assets to an "Unsuitable Third Party" – the definition of which a) appears draconian in relation to a material interest in the production of alcoholic drinks and b) the determination seems to be outside the control of the other shareholders, and wholly under the control of the public sector - "Any person whose activities are, in the reasonable opinion of HMTCo, incompatible with the provisions of xyz services". This appears to be unreasonable, particularly in the event, that after the transfer HMTCo should then decide to state that such persons were 'unsuitable'. If such a decision is made, it should be prior to and not post the sale. In addition, there should be included a clear rationale as to how any shareholders' activities could be deemed to be incompatible rather than this catch all clause. Objective criteria would clearly be preferable.

We also believe that uncertainty in relation to the nature of an 'unsuitable' person will impact on the value and liquidity of shares, particularly if it is a post event determination and therefore lead to higher potential pricing.

The process for the deemed transfer provisions with the inclusion of a sale agent process appears to be long drawn out. There is a 20 day period for remedy – longer than we have seen in a number of agreements, then at least 21 days for the Deemed Transfer Notice arrangements, followed by a further 60 days for the Sale Agent process. During this time – around a minimum of three months and potentially longer. The SPV that will have been created with the purpose of providing services to the public will effectively be left in limbo for an extended period. We feel that this period of uncertainty should be limited to a maximum of 20 days.

We also feel that there may be additional costs involved in appointing a sale agent that would need to be factored into the arrangements.

9. Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?

We are comfortable with the role of the Valuers, and their role as experts rather than arbitrators.

In relation to the instructions being given to them, we are concerned about the earlier references to an 'Unsuitable Party' – if this matter is not defined at the outset there is a strong possibility that share valuation will be impacted. Otherwise the approach to valuation will incorporate an unreasonable element in that the Valuers are presently being asked to ignore any restrictions on the transferability of the Sale Shares.

We are prepared to support the idea of no premium or subtraction with reference to the size of the holding but if this size issue is the subject of the Transfer Notice or there is another matter. We believe that c) is too 'catch-all' and that it is more appropriate to define how Market Value may be achieved from the outset.

10. What are your views on the proposed arrangements for nomination and composition of the Board of Directors ?

This approach would be appear to be standard in the context of other shareholders' agreements we have entered into.

11. Do you agree with the provisions relating to the Chairman?

We support the approach to the appointment of a Chairman, as an influential Chairman can provide strong direction and support to corporate decision making and affairs. Again, if an independent non-executive Chairman is appointed, there will be a cost implication in relation to his time that will need to be factored in.

12. Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements a) when HMTCo is a shareholder and b) thereafter

In general terms, we have no issue with an observer being present at an SPV board meeting. However when HMTCo is a shareholder, there will be HMTCo directors at the board who will be representing the interests of the public sector and the role of the observer would therefore be uncertain. Post HMTCo departure, it would appear that the observer is still present representing the public interest and would therefore be more relevant. In either case, we believe that it is important that there is an agreement stating the exact role and responsibility of the observer, their reporting lines, influence on corporate affairs, impact on decision making and if there are specific areas in which they will become engaged as well as potential or actual conflicts of interest.

We would comment that with public sector directors, and substantial data being provided to the public sector on a regular basis, that there is a cost involved in engaging an observer at board meetings as well that may not represent value for money.

13. Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters

A5 and A6 appear as curious inclusions as the company would presumably set up a single purpose company with detailed contractual arrangements and any change of direction would be heavily restricted as per normal PPP companies.

B11 would appear to be a matter more for shareholders than the board. This would be particularly relevant where the identity of the purchasing shareholder would need to be taken into consideration.

14. Do you think that the proposed arrangements regarding a Director's conflict of interest are practicable?

From our perspective, we believe that directors who have a specific conflict in relation to a specific matter to be discussed or voted upon at the board, should exclude themselves from discussion and from voting on that matter. We believe that there should be a clear separation in board terms from the underlying contractual arrangements, and shareholders who have an additional interest in providing services to the company who have now come into conflict into the company should not be represented at meetings considering such matters. This should apply equally to public sector directors and observers.

15. Please give your views on the proposed dispute resolution arrangements.

These appear to be in line with the dispute resolution arrangements that we would normally expect to see, although we would prefer that it is clear from the outset that expert arbitration would be binding, rather than having to refer the dispute to the courts that may constitute a very uncertain time period.

16. Do you agree that shareholder loan stock should be unsecured?

Yes – these are non-recourse transactions for shareholders reliant on the contractual documentation.

17. The Bidder incurs costs and risks in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support this, how would this be structured – in particular do you think a higher interest rate on loan stock is an appropriate mechanism.

The costs incurred by a bidder can be calculated on financial close, and will usually be paid in the form of a fee to the bidder., As well as a fee, bidders who have been engaged in the development phase will often expect to have an inherent higher rate of return than subsequent entrants as they will have carried a higher level of risk from an earlier stage. One of the approaches to this is to net present value a future differential and ask that new entrants pay a further 'equalising' fee to those involved in the bid stage. This means that subsequently the returns to the investors are paid out on a pari passu basis. This is effectively what will happen when any secondary investor enters the project.

Differential rates of return paid to different investors are likely to result in highly complex and time consuming negotiations leading to delays – the calculation of these in a dividend payment is extremely complex. If, for example, there is a shortfall in the expected level of dividends or a substantial equity risk is realised (e.g. a subcontractor becomes insolvent and needs replacing, with the consequent delay) then there is a potentially difficult negotiation – if the developer is at one level of return and the later coming investor at a lower rate, is the risk calculated on a pari passu basis or are the later investors going to expect a corresponding lower level of risk related to the lower return?

It is potentially easier to apply an enhanced return regime to loan stock, as the rate of interest can be varied however in general terms we would be against this as it means that investors are not aligned in the process, which may be in calculation terms un-necessarily complex. For example, on each payment date a separate calculation would need to be made, and whilst loan stock payments may be more stable than equity there is still a possibility of a shortfall and a re-proportioning of payment. In addition payments on loan stock can be delayed or locked up and this can further increase the complexity. It is far better for balancing payments to be made upfront than over the period of the project.

18. Any other business.

Meridiam's main concern in this proposed structure is not the incorporation of public sector equity but the proposed division of identities of private sector partners that will result from the structure.

There are references throughout the documents to the concept of a 'Developer' – an entity who will bring a project to financial close, and then exit from the project for a fee or benefit. There is a 'Third Party Equity Investor' characterised as only looking at the investment as a financial opportunity. Incentivising long term investment by ensuring that all parties retain the longest possible interest in the project is not mentioned. The Kay Review of July 2012 highlighted the need for long term investment and stewardship, and the recent EU Green Paper on Long Term Financing of the European Economy has also focussed on the need to incorporate long termism into thinking and practice.

Meridiam does not believe that taking a short term and fragmented perspective of investment into PF2 projects is beneficial as there are too few incentives to enhance stewardship of the provision of vital services to the public. There appears to be a distinct lack of alignment of interest in investors, categorised as follows:

– the **developer** who may bid unreasonable terms to secure a project, in the knowledge that they then may exit and the project will sink or swim without them.

– the **financial investor** who has not had experience in negotiating the project but is reliant on documents provided at financial close – they may be looking for long term investment in which case they should enter the project as early as possible and be provided with long term management support from the developer

– the **public sector** who appear to be looking to exit at an early stage

As mentioned earlier there is no one party who is particularly knowledgeable about the delivery of projects over the life of the project. Meridiam's strong preference remains for a longer term perspective in developing PPP projects where investors work on the project from the outset, understand the key issues and documentation fully, provide and support management efforts and deal with disputes from a position of knowledge and that all parties bidding for a project remain for the longest possible period.

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PPP Policy team
HM Treasury
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09 August 2013

Dear Sir/Madam,

Response To

A new approach to public private partnerships: consultation on the terms of public sector equity participation in PF2 projects

The following is the Miller Construction (UK) Limited response to the above consultation.

General Comments

Our overarching comment is that, subject to the specific points later in this response, we are broadly comfortable with the structure suggested. There does however seem little point in a consultation without any significant pipeline of projects. Rather than consulting on an approach we would far rather hear about workloads – even if this is to say there will be nothing for some time - as the current uncertainty is making planning extremely difficult. Certainty, as early as possible, will secure jobs and skill base in the medium to long term.

Whether the PF2 approach to equity is correct would be best tested in the market place. To this end we would suggest a couple of pilot schemes and an undertaking to revise, where required, going forward – this is an approach that has been successful on a number of other procurement models, notably LIFT and BSF.

As a sponsor our specific concerns regarding the proposed approach circulate around two main areas

Firstly, we appreciate the need for flexibility however as a sponsor we would welcome certainty early on in a bid. The idea of a *'right but not an obligation'* to invest does not give sufficient clarity of either quantum of finance required or potential workload /commitment to fill any gap – see our detailed response to consultation question 2.

Secondly, we believe the approach detailed could discourage medium tier contractors from bidding. Historically, equity co-sponsors have shared an element of bidding costs however the new proposals would in large part preclude this as many of the traditional equity sponsors will wish to either partake in the simple equity competition or indeed have a role at aggregator level. This means that sponsors are left with the entirety of the bid costs.

Moreover, these costs appear set to increase under this regime with extra work and extra advisor costs. Whilst bidders can adjust models to recoup this loss, it significantly changes the risk profile, and we do not believe a differential rate of return addresses this issue - see our detailed response to consultation question 17.

Should you wish to discuss the above or our responses to the consultation questions attached below please do not hesitate to contact me directly.

Yours Sincerely

[redacted]

Mark Baxter

Investment Director

Miller Construction (UK) Limited

Note Referred: Specific Reponse to Consultation Questions

Q1 A standard format DD questionnaire from the procurer at the outset would be helpful. A co-ordinated set of sensitivities would also be helpful to avoid multiple but very similar sensitivities to funders.

Q2 Once a bid starts we believe the public sector should commit to their share.in stronger terms. Whilst this commitment could be caveated around certain commercial criteria, the uncertainty at this point is unhelpful to bidders. Informal consultation at the same time as a dialogue, whilst possibly helpful, is an additional burden on both bidders and the authority. If the consultation is informal how much reliance can be placed on the discussions?

Q3 By and large no, we are happy with sharing this information with the public sector. We are however less happy about this information being publicly available to our competitors.

Q4 See response to Q2. We are concerned about the potential workload in the equity competition and the practicalities thereof however the principle is reasonable. We would welcome tag along rights (albeit these could be capped) for sponsors were HMTCo to sell some equity within the lock in period. This could go some way to addressing our concerns at Q17 and may benefit the overall price achieved for both parties.

Q5 Project dependant. If the project is one where the developer can benefit from future works and the working capital is essentially speculative, then the approach seems sensible. Where the project is one where simply due to the financial model economics certain periods require an overdraft facility then this is something that should be provided by ProjectCo.

Q6 We agree. Furthermore we would expect that if a party subscribes for 30% of the equity they will be required to subscribe for 30% of the loan stock. This is not explicit but seems to be implied within the documentation.

Q7 Our corporate position is that we are not in favour of pre-emption rights. However if the pre-emption rights are as described *'a right of first refusal'* with the sponsor free to sell at a higher price if agreement cannot be reached then this is in line with what we would seek to do in any event. We would urge that this mechanism be kept very simple.

Q8, 9 and 10 No comment.

Q11 Yes

Q12 No

Q13 Reasonably large piece of detailed work which we feel would be better undertaken in a live project.

Q14 Yes

Q15 No Comment

Q16 Yes, although if co-equity insisted on security we would wish to be pari-passu.

Q17 Differential rates of return are not a way to address bid costs. Bid costs are an in-period cost whilst differential returns will accrue over the life of the project. Development fees will need to be sized to ensure that a bidders P&L is balanced in the short term. There is a risk here that the approach will lead to higher bidding costs and that the anticipated third party equity pricing does not sufficiently compensate for this meaning that vfm goes down. The additional vfm issue here is that with fixed bidding budgets sponsors are likely to bid for fewer projects lowering competition. One way to address this would be to award an element of losing bidders costs.

Q18 No further comments

MORGAN SINDALL INVESTMENTS

HM Treasury
A new approach to public private partnerships:
Consultation on the terms of public sector equity participation in PF2 projects

A response from Morgan Sindall Investments Limited

General Considerations

Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements?

We do not have any material comments at this stage on the process and in particular the Due Diligence Memorandum. We would however like to better understand the role of the Treasury PF2 Equity Unit at this point in the process – for example, we assume that its role will be passive and that it will not seek to re-negotiate agreed terms. Furthermore, we assume that if the contents of the Due Diligence Memorandum are problematic for the Treasury PF2 Equity Unit that its option at this point would be to not invest? It would also be helpful to better understand the detail of the process generally, and in particular the nature of the 'PF2 Equity Bid Information'. Finally, in respect of the due diligence carried out prior to preferred bidder to assess risk allocation between the SPV and the supply chain, will this be marked in the evaluation as whilst the risk allocation will not affect VFM for the client it may impact on VFM overall?

Question 2: Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.

We understand the rationale for separating this from the main dialogue and have no material comments to make at this stage.

Question 3: Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.

We do not have any objections to the new transparency requirements.

Question 4: What are your views on the following arrangements to promote new equity investors?
(a) Equity funding competition post appointment of preferred bidder?

We would make the following observations:

- Is the preferred bidder free to determine the size of the competed equity slice?
- Who takes the risk as to the competitiveness of the competed equity?
- We assume the key driver here (in addition to widening the market) is a reduced price. Is there evidence that equity will be forthcoming at preferred bidder stage at significantly lower rates? Whilst bid cost risk will not be present, construction risk will be.
- Can the preferred bidder have a third party equity provider forced on it? How much discretion does the preferred bidder have as to who it approached/can somebody not approached insist on being included?
- Is this considered appropriate for all schemes, irrespective of value? The benefits may be limited when the extra costs associated with the both the competition and the post-competition due diligence are factored in.

(b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?

We do not have any issue with this principle.

Question 5: Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.

We do not have any fundamental issue with this proposition. There is an argument to say that, as per Scottish HUB, the working capital should be provided pro rata to shareholdings, but provided that the developer has the ability to dictate the terms of the working capital provision where it provides it all then we are relatively relaxed. Likewise, we would have no issue with the other shareholders participating on the same terms as the developer terms in proportion to their shareholding. Ultimately though we appreciate we may be required to provide all the working capital.

Shareholders Agreement (SHA) and Articles of Association (Art)

Restriction on share transfers (SHA Clause 9 and Art 11 to 15)

Question 6: Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?

We are aware that there is some concern in the market that this could be an issue in terms of tax treatment (with the sub-ordinated debt being treated as equity) but notwithstanding that we are comfortable with the principle of stapling.

Question 7: What are your views on the pre-emption provisions?

These are acceptable as drafted.

Question 8: Do you agree with the event of default and deemed transfer provisions?

We do not have any comments to make.

Question 9: Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?

We have the following comments on the definition:

- We would expect limb (b) of the definition to exclude a forced or liquidation sale
- Limb (b) should be subject to limb (c)
- The valuer should be obliged to take genuine third party offers in to account when determining the Market Value

Board of directors (SHA Clause 5 and Art 3 to 8)

Question 10: What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.

We do not have any comments to make.

Question 11: Do you agree with the provisions relating to the chairman?

We do not have any comments to make.

Question 12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?

We do not have any comments to make.

Reserved matters (SHA Clause 6.2 and schedule 8)

Question 13: Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.

We would question the inclusion of Reserved Matters B11 (A sale, lease, transfer or other disposition of the whole or a material part of a Shareholder's undertaking in the Company (where 'material' means having a value of more than £100,000). Why should this be subject to Board approval in this way?

Question 14: Do you think the proposed arrangements regarding a Director's conflict of interest (SHA Clause 6.3) are practicable? If you prefer a different arrangement, please propose this and give your reasons for this preference.

We do not have any comments to make.

Dispute resolution (SHA Clause 11)

Question 15: Please give your views on the proposed dispute resolution arrangements (SHA Clause 11).

We do not have any comments to make.

Loan Stock Instrument

Question 16: Do you agree that shareholder loan stock should be unsecured?

Yes.

Question 17: The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?

We are of the view that any third party equity provider who successfully competes for equity through a competition prior to financial close should see a return which reflects the fact that they have not been exposed to bid risk. In simple terms, this reduced return could be achieved in two ways – either through a lower coupon or by payment of entry premium (effectively reducing their interest rate). Our view is that it is preferable to adopt the entry premium route as this avoids potential problems which can flow from loan notes with different profiles (the different shareholders will have different attitudes to loan protection v equity). Whether that premium is paid to the developer or applied for the benefit of the project in some other way will need further consideration. It might be, for example, that developers will be prepared to bid more competitively if they know that a premium will be paid by the incoming third party equity provider.

Other issues

Question 18: Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.

- Clause 4.1 of the Shareholders' Agreement – We would prefer the option to utilise an equity bridge rather than subscribe on day one.
- Clause 8.4(a)(iii) of the Shareholders' Agreement – We would like to see some capping of the time and cost demands in this regard.
- Definition of Unsuitable Third Party in the Shareholders' Agreement – Whilst we agree with the policy driver behind it, we have some concerns over limb (d). In particular, whether this will be something we are aware of/are able to determine at the time of a sale. We think consideration should be given to a relaxation where a transfer occurs to an Unsuitable Third Party falling within limb (d) where having made all proper enquiries we are not aware of the fact at the time.
- Although not directly relevant to this consultation, we do think it worth flagging the approach being taken to funding (and as a consequence third party and public sector equity) in the Priority Schools Building Programme. We think the 'Aggregator' model is a good one and would welcome its use in other sectors.

A NEW APPROACH TO PUBLIC PRIVATE PARTNERSHIPS: CONSULTATION ON THE TERMS OF PUBLIC SECTOR EQUITY PARTICIPATION IN PF2 PROJECTS

RESPONSE TO CONSULTATION BY NABARRO LLP

1. INTRODUCTION

1.1 This response to the consultation is from Nabarro LLP.

1.2 We act for a mixture of private sector and public sector clients and advise on a broad range of infrastructure projects including in the education, healthcare, housing, waste, climate change and energy sectors.

1.3 We believe it is a desirable and achievable goal to have standard form documents in relation to PF2 and we note that in our experience the Building Schools for the Future ("BSF") shareholders' agreement is a successful example of such a document, which was largely acceptable to all parties and rarely negotiated.

1.4 We generally welcome the proposals in the consultation, but raise concerns below as to whether:

1.4.1 There may be a better and more consistent approach to the transparency provisions;

1.4.2 The public sector's Lock In Period is sufficient to protect shareholders during the most high risk phase of the project; and

1.4.3 The provisions for shareholder debt in the proposed Shareholders' Agreement ("SHA") are sufficient.

1.5 Our response below addresses a selection of the consultation questions where we feel we have constructive comments to make on the proposals.

2. Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.

2.1 As part of the transparency provisions HMTCo is entitled to nominate a board observer to the board of ProjectCo. We believe this will make projects more transparent and will help to streamline the interests of the private and public sectors.

2.2 We note that HMTCo will report on a regular basis to the procuring authority regarding the performance of the relevant investment. In the interests of transparency, we think the presence of an authority observer at regular ProjectCo board meetings should be sufficient. This would remove the requirement for HMTCo to report to the authority "behind closed doors" but would still ensure the authority is fully aware of ProjectCo business.

3. What are your views on the following arrangements to promote new equity investors?

a) Equity funding competition post appointment of preferred bidder?

b) Reduction in HMT Co equity post financial close (either during the Lock in Period or thereafter)?

3.1 Lock In Period

3.1.1 Although we understand the public sector's desire to be able to free up funds so that it can invest in other projects, it is important for ProjectCo to have stability during the construction phase and early stages of operations and any Lock In Period should reflect this.

3.1.2 We believe that there should be a Lock In Period of at least one year post construction completion, reflecting the restrictions on share transfers generally imposed on private sector equity investors in accommodation based schemes. The period may need to be longer for the sectors (e.g. waste, renewables).

3.1.3 We agree that any transfer of Treasury invested equity should not be restricted to public bodies. The Treasury should have the option to transfer its equity to a commercial third party of good standing (subject to the usual restrictions around Unsuitable Third Parties).

3.2 Equity Funding - Treasury

3.2.1 While we acknowledge the benefits to, the public sector of having flexibility in the process, we are concerned that the Treasury's position on equity funding may be too uncertain in the initial stages of a procurement.

3.2.2 We suggest that the Treasury either:

(a) confirms how much public sector equity will be made available up front, as part of the tender documents; or

(b) asks bidders to submit variant bids based on two or three funding scenarios.

3.2.3 It should also be clear whether or not the main sponsors will have the option to act as equity investors of last resort (instead of the Treasury) where market uptake, as a result of the funding competition, is not as expected

4. What are your views on the pre-emption provisions?

4.1 We suggest that the identity of any third party to which an existing shareholder wishes to sell their shares is disclosed to the other shareholders before the pre-emption process begins. This will give shareholders the opportunity to consider whether they would rather purchase shares themselves than have them taken up by a particular third party.

4.2 It may be logical to extend the pre-emption provisions so that they also apply to shareholder debt since it is unusual in our experience for a shareholder to part with their shares and not with their loan stock (so long as the shares and loan stock are stapled, which we agree they should be).

5. Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?

5.1 We are of the opinion that the shares and loan stock should be valued together and that the definition of "Market Value" should refer to both of these items.

6. What are your views on the proposed arrangements for nomination and composition of the board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.

6.1 We suggest that instead of shareholders appointing a new director for each 15% of equity held, that only one director is appointed for that shareholder, but that their voting is weighted to reflect the level of equity held.

6.2 This approach will keep the board small and will give a more accurate reflection of shareholdings held.

7. Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.

7.1 We suggest that Schedule 7 of the Shareholders' Agreement ("SHA") (Transparency Information and Commercially Sensitive Information) should be open to negotiation between the parties on a project by project basis. This flexibility will ensure that any particular needs of shareholders can be reflected. Including examples in the standard form would still be worthwhile.

8. Please give your views on the proposed dispute resolution arrangements (SHA clause 11).

8.1 Current drafting deems any "disagreement or dispute between two or more of the parties" a Dispute. We believe it would be helpful to make the definition of dispute a less broad one and suggest that a dispute occurs in instances where there is a deadlock on the board which is stopping decisions from being made and ProjectCo moving forward.

8.2 In the case of a deadlock we believe that the decision of any expert should be binding and final and that the parties should not have discretion to disagree with the expert as is currently the case.

9. The bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?

9.1 We do not believe that a different rate of return should be given to equity investors making financial commitments at a later stage in the procurement.

9.2 Incoming equity investors will join a bid by way of a funding competition and the basis of their bid will include, amongst other things, the proposed rate of return. We see difficulty and unnecessary complication in artificially depressing that rate of return.

10. Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.

10.1 The Treasury should ensure that they build sufficiently flexible provisions into the SHA which will allow them to transfer their investment into another Treasury owned vehicle and not trigger change of control provisions in the Articles/SHA. We note that this is anticipated by the draft SHA.

10.2 The provisions in SHA clauses 4.2 and 4.3 are not sufficient to address the issues arising from calls for additional shareholder debt. We would welcome an expansion of SHA clause 4.4 (Shareholder Debt) to specifically cover issues around the process of requesting additional shareholder debt, interest rates on such debt, when the debt is payable, security provisions etc.

NABARRO LLP

21 August 2013

A new approach to public private partnerships

Consultation on the terms of public sector equity participation in PF2 projects

Norton Rose Fulbright LLP comments on draft Shareholders' Agreement

Please see below our comments on the draft Shareholders' Agreement. As the consultation questions are targeted towards investors, who will be able to give a more commercial view on the drafts, we considered that it would be more useful to provide a legal view on specific clauses of and issues arising from the draft Shareholders' Agreement.

	Issue	Clause	Commentary
1.	**Subscription at signature**	**4.1(b)**	This clause envisages that the shareholders will subscribe for shareholder debt at signature. Although HMTCo may wish do this, there is no recognition that other shareholders are more likely to bridge their shareholder loan commitments with bank lending and subscribe on project completion. We suggest the draft at least makes some reference to the fact that an equity bridge may be in place and an equity subscription agreement for future funding. We would also suggest some guidance on whether HMTCo will have to follow the private sector shareholders and subscribe when they do would be useful.
2.	**Further is issue of shares and shareholder debt**	**4.2**	As a Reserved Matter, we note that the issuance of additional shares and shareholder debt requires the prior written approval of each Material Shareholder, which will include HMTCo whilst it is still a shareholder. Although there should not be an obligation placed upon HMTCo to inject additional funds into the project, a situation may arise whereby the private sector shareholders need to do so in order to cure a default under the finance documents and avoid a wider project default. The finance documents will usually permit such a cure to take place (usually referred to as an "equity cure"), however if a minority shareholder were able to veto a rescue refinancing (which, as currently drafted, they can do), even if they were not injecting money into the project themselves, this could force a struggling project into default. We suggest an alternative mechanism be introduced which enables additional debt and equity to be injected without all shareholder consent. A good example of a recent project where such a mechanism was adopted would be the Norfolk Waste PFI.

	Issue	Clause	Commentary
3.	**Absent Directors**	**5.5(a)(iii)**	Whilst the current drafting seeks to address the issue of an absent director by allowing those present to vote for them, this could lead to dispute if there are three or more Directors appointed by a Material Shareholder and one is absent. There is no guidance as to which of the remaining Directors will be entitled to vote for the absent Director and no provision for what to do if the remaining Directors do not agree which way to vote.
4.	**Observers**	**5.6**	Whilst the concept of the Observer is consistent with HM Treasury's desire to improve the transparency of projects and to open up dialogue between the public and private sector, we would expect private sector stakeholders to have some issues with the attendance of observers at board meetings, particularly given the lack of clarity over whom such observer might be. Consideration should be given to including a pre-agreed list of potential observers to be agreed on a project specific basis. Consideration should also be given to dealing with the need to ensure openness and dialogue with local stakeholders through the introduction of mandatory liaison meetings rather than board meeting attendance. Attendance at board meetings will likely lead to project companies having to hold two-tier meetings with the observer being excluded from part which will be administratively cumbersome for the project companies to manage and ultimately possibly not as informative as separate liaison meetings.
5.	**Votes attaching to shares**	**9.1(e)(ii)**	As drafted, HMTCo is permitted to enter into agreements in respect of its votes attaching to their shares whereas the other shareholders are not. It is not clear what arrangements in respect of the votes attaching to their shares HMTCo are envisaging entering into, so some clarification on this point would be welcomed.
6.	**Sale of default shares**	**9.6**	The ability of non-defaulting shareholders to elect a "Suitable Third Party" to purchase the shares for par value and the debt for zero should only be permitted if the other non-defaulting shareholders do not wish to purchase those shares. It should not be the case that a new shareholder can come into the project by purchasing shares and debt at the par value of the shares whilst existing shareholders are willing to make additional purchases.

	Issue	Clause	Commentary
7.	**Lock-In**	**9.7(iii)**	This clause permits HMTCo to transfer their shares at any time, including during the lock-in period. The reasoning behind this it to facilitate the entry into the project of new long-term equity investors. However, although we presume that pre-emption will still apply, there is no guidance relating to the corresponding transfer of shareholder debt. If HMTCO subscribe for their shareholder debt at close then on a sale you would have some private sector shareholders with debt subscribed and some with debt being bridged. This is likely to cause tensions amongst shareholders unless HMTCo will always follow the private sector in the timing of subscriptions.
8.	**Change of Control in private sector shareholder**	**9.7(b) and (c)**	The effect of these two clauses is to disallow any change of control in the private sector shareholders during the lock-in period. We consider that there are situations whereby preventing a change of control is beyond the control of the private sector and that some thought should be given as to how far up the chain of ownership this restriction should extend and whether there should be a carve out from this for public companies. There is also no clear guidance on what would happen if such a change of control took place. Would this mean that the private sector shareholders would become defaulting shareholders and suffer the consequences of this through (potentially) no direct fault of their own? Who should have the right to waive this control – HMTCo only or all remaining shareholders?
9.	**Transparency**	**Schedule 7, Part B**	Under Part B, shareholders must provide information in relation to the identity of each person having a beneficial interest in those investments. Although provision has been made to add carve out language for public companies, it is unclear how far up the chain this information should be provided for. We would suggest that there should be a limit applied. This provision is likely to be particularly difficult for funds to comply with. The transparency obligations in the draft Shareholders' Agreement are onerous and the open-ended burden placed upon the Company to deal with requests for information could be extremely cumbersome and costly. We would anticipate bidders wanting to look to tighten these requirements to make them more manageable.

Norton Rose Fulbright LLP

16 August 2013

21 August 2013

Consultation on the terms of public sector equity participation in PF2 Projects

A response from the PPP Forum

About the respondent

Established in 2001, the PPP Forum is the private sector industry body for the PPP/PFI industry.

The PPP Forum's mission and approach is to:

- demonstrate the success that PFI is achieving in delivering modern public service infrastructure
- take part in public debate and present an informed and business based perspective on PFI and the issues surrounding it, and
- monitor Government policy and practice, and to engage with Government departments and related organisations involved in developing PFI policy and delivery.

The response below follows the chronology of section 7 of the "Consultation on the terms of public sector equity participation in PF2 Projects" questionnaire.

General considerations

Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements?

- As an introductory comment, the requirement for public sector equity and the potential for an equity funding completion both reduce the available equity for the Developer sponsor(s). This has an adverse impact on the risk and reward for bidding for PF2 projects that might deter certain current market participants from still bidding for PF2 projects unless there is a change to the way in which bid cost risk is shared.

- The obligation to provide PF2 Equity Bid Information is not objectionable provided the scope of the information requested does not place an unreasonable burden on bidders.

- Similarly, providing a limited number of equity case financial model sensitivities at the preferred bidder stage is acceptable in principle, subject to level of detail required at the time.

- The requirement for a Due Diligence Memorandum will place an additional burden on the preferred bidder and their advisers: for example, whilst legal advisers to bidders' lenders will typically prepare such a report, bidders counsel do not.

- Similarly, bidders' advisory teams in a PFI project do not typically give reliance letters (as might be the case in other sectors where definitive reports are made available): rather, initial engagement terms are typically novated to the project SPV which then has the benefit of previous advice given. If there is no formal advisory report (as is typically the case), then framing a reliance letter will be challenging.

- Providing the Treasury PF2 Equity Unit with a copy of reports prepared for Senior Lenders, and reliance letters regarding the same, will need further consideration, as it is not market practice for sponsor equity providers to have these.

- In summary, the formalisation of diligence and reliance requirements set out in section 4 of the consultation document does not reflect current market practice for third party equity providers. We suggest that members of the Treasury PF2 Equity Unit either engage their own advisers or participate alongside all other equity providers in the preferred bidder phase, taking advice "in the ordinary course" rather than imposing additional and inefficient administrative requirements.

Question 2: Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.

- Informal guidance will always have some value, but it seems to us that the real decisions will only be taken at the preferred bidder stage and we question how much weight bidders will place on any guidance provided at an early stage.

Question 3: Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.

- Certain participants in the PF2 market will have difficulty with the requirements of Part B of schedule 7 to the draft shareholders agreement (disclosure of ownership), and some flexibility should be contemplated.

- Certain members of the PPP Forum consider it inappropriate that disclosure of the Transparency Information could continue after HMTCo ceases to be a shareholder.

Question 4: What are your views on the following arrangements to promote new equity investors?

a) Equity funding competition post appointment of preferred bidder?

- As above, reducing available equity for initial Developer sponsors changes the risk-reward around bid costs and may deter certain bidders from taking development risk, as they could take 100% bid cost risk but end up with a smaller investment unless a right to match is offered. This might reduce third party equity participation in the early stages of PF2 procurement processes, potentially losing the benefit of structuring expertise. This outcome would place an additional burden on design builder developers regarding the funding of bid costs and the resourcing of bids.

- We do not think an equity funding competition will promote new equity investors, but rather will provide a different route for existing investors to invest in PF2 – reducing early stage involvement. Barriers to entry for institutional investors would remain: balancing the amount of expertise and management resource required versus the investment size in the current pipeline for PF2 projects.

- The experience of many PFI/PF2 participants is that there is no preferred bidder premium available in the market for third party equity investors that join a consortium at that stage. Rather, development phase (ie construction risk) equity is competitively priced, and no discount is applied to target IRRs: the price for entry at that stage is sharing bid costs, not an equity premium.

- If the equity funding competition does identify third party equity providers willing to provide equity at a more attractive price than Developer sponsors, it is not clear how this will be factored into the model. Will the excess over modelled IRR be returned via a waterfall or will equity be acquired at a premium? In any case, it will be important the preferred bidder's equity cashflow assumptions are maintained, so as not to adversely impact on the debt covenants and ratios in the winning bid financial model.

- Finally, some level of control over which third party equity providers are invited to participate will be important. PFI projects are long term operational projects and the identity of shareholder partners is key.

b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?

- The majority of the members of the PPP Forum are likely to have no objection to the HMTCo exiting during the lock-in period, but the ability of HMTCo to acquire a larger percentage with the intention of selling-down during the lock-in period exacerbates the scarce equity, risk-reward and bid cost issues described earlier.

Question 5: Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.

- We do not think this topic is relevant to the majority of PFI projects. But if project specifics require definite additional funding, we would expect this to be provided equally by all equity providers by way of contingent equity/sub debt.

Shareholders Agreement (SHA) and Articles of Association (Art)

Restriction on share transfers (SHA Clause 9 and Art 11 to 15)

Question 6: Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?

- Transfer of the two instruments should be required pro-rata, so that equity governance and economic exposure are aligned by each shareholder group. However, this stapling should not restrict intra-group reorganisation of the holding of those instruments if future tax efficiencies can be found.

Question 7: What are your views on the pre-emption provisions?

- The definition of HMTCo Group seems very wide.

- Pre-emption provisions are not viewed by up-front investors equally: contractors that are likely future sellers may prefer more freedom; financial investors often favour a tight pre-emption process. As a compromise, there is sometimes freedom to sell after the relevant lock-in period but each investor will have its own view on this issue.

- A subjective definition of "Unsuitable Third Party" will make equity transfers subject to unnecessary process risk: it should be clear and objective to whom equity can be transferred. It is also not clear to us why this principle should differ from the equivalent project agreement position.

- The process set out in schedule 5 is unlikely to result in full pricing: for example, no warranties are to be given on any sale. This exacerbates the risk around deemed transfer described below.

Question 8: Do you agree with the event of default and deemed transfer provisions?

- Different investors have different views: for some, any deemed transfer provision is an unacceptable "poison pill"; others accept this for insolvency and breach of the share transfer provisions but not for general breaches.

- On balance, we consider that the potential for loss of equity for event of default at par is off-market, and that dis-enfranchisement of shareholder rights unless and until the relevant breach is resolved is a more balanced solution.

- The events of default, as defined, are wider than commonly used. For example, actions by a shareholder unrelated to the project (paragraph (e) of the definition) would not normally have consequences at project company level.

Question 9: Do you have any comments on the definition of ‘Market Value’ and the manner in which this will be determined?

- No comments.

Board of directors (SHA Clause 5 and Art 3 to 8)

Question 10: What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.

- 15% interest for a director may be acceptable, but typically these numbers are flexible to reflect that actual percentage holdings of the shareholders on a case by case basis. We would suggest being more flexible.

- In the majority of cases, directors' votes are proportional to % shareholding of their appointing shareholder, to avoid the need for too many individuals to be appointed. In the structure proposed, the cap of three directors could work against a majority shareholder, who could not obtain control at board level.

- The provisions to disenfranchise directors from voting apply at a much earlier stage than is typically the case: ordinarily, dis-enfranchisement only applies for actual or contemplated enforcement or litigation, rather than where a claim is "asserted" and is still being commercially resolved. Disenfranchisement should also apply to HMTCo regarding litigation against the Authority.

Question 11: Do you agree with the provisions relating to the chairman?

- This is a matter of preference for each individual investor and we have no strong collective view.

Question 12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?

- This is likely to be acceptable, although there is a strong view among many sponsors that the project agreement is a better place to provide for such a right.

Reserved matters (SHA Clause 6.2 and schedule 8)

Question 13: Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.

- The list of Reserved Matters is conventional, but we understand that certain sponsors will seek to supplement this list to reflect their own practice.

- It is unusual for all reserved matters to require unanimous consent. Ultimately, the percentage thresholds are determined by the actual shareholding on a case by case basis, but it would be unusual for a minority shareholder to have full veto rights over the complete list of Reserved Matters you have provided – a lower threshold for non-fundamental matters is common.

- There may also be sponsors that have structural requirements for greater delegation to the board, rather than the proposed elevation to shareholders under the reserved matters regime.

Question 14: Do you think the proposed arrangements regarding a Director’s conflict of interest (SHA Clause 6.3) are practicable? If you prefer a different arrangement, please propose this and give your reasons for this preference.

- Referral from directors to shareholders is a standard procedure for managing director's legal conflict concerns.

Dispute resolution (SHA Clause 11)

Question 15: Please give your views on the proposed dispute resolution arrangements (SHA Clause 11).

- The procedure seems standard, but it should be clarified that there is no "Dispute" if a decision is effectively blocked because a relevant threshold at board level or under the Reserved Matter regime is not achieved.

Loan Stock Instrument

Question 16: Do you agree that shareholder loan stock should be unsecured?

- Yes. In passing, we note that your proposed form of loan note instrument is cumbersome, and, typically, a shorter form (eg, without provisions for meetings of noteholders) is more commonly utilised in the current market.

Question 17: The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?

- See answer to question 4.

Other issues

Question 18: Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.

- In previous discussions with HMT, our recommended approach was for HMT not to issue a standard form suite of documentation: established bidding consortia have their own preferred routes to document project company ownership and, as a minority investor, it would be more appropriate for HMT to provide for its minority rights on a bespoke basis, rather than drive the entire framework.

- The draft shareholders' agreement envisages a single "Developer" equity provider, alongside HMTCo and third party equity providers sought via a PB equity funding competition. We expect that HMT still wishes to see financial investors as part of consortia from "day 1" (sharing bid costs and helping to structure bids). If so, then contractor equity and day 1 financial equity should be invested independently and not amalgamated via a single Developer holding entity. The provisions for dealing with conflicts would be wholly unacceptable if the intention is for financial equity to invest via a single Developer holding entity.

- We would welcome an explanation why HMTCo is exempt for the security restrictions in clause 9.1(e). Also, some indirect security over shares in a PF2 project may be required of shares in the holding company for those investors that have portfolio financings. Is it intended that funders will not have share security over HMTCo's shares, as if not HMTCo's interests are even further dis-aligned from other shareholders.

- Blocking equity transfer while a shareholder (or associate) is in material breach of a project contract is off-market.
- Disclosure provisions may need to be widened to accommodate particular investors' ownership and reporting structures.
- Whilst the private sector has accepted the requirements around FOIA in the context of the PF2 agreement, this position may need further consideration given the wider access to commercially sensitive information that HMTCo has as shareholder in the project company.
- Sponsors not wholly based in the UK may take issue with the notice requirements of clause 5 requiring notice to be given only to directors present in the UK.
- We have been supplied with a number of other comments on the detail of the draft documents that we would be happy to discuss with you.

A new approach to public private partnerships: consultation on the terms of public sector equity participation in PF2 projects – SWBH /Pinsent Masons response

Question	**Response**
General Considerations	
Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements?	It is not clear what (if any) additional work the provision of the PF2 Equity Bid Information is going to generate for the bidders. If it is a considerable amount and then it is decided that there will be no public sector equity, this could cause frustration amongst the bidders. The exact timing of the due diligence (and how this fits in with funding competitions and private sector equity) is still not completely clear – "before the appointment of preferred bidder". It is understood that where, at OBC stage, the Government determines that public sector equity should be invested in the project, this gives the public sector the "right but not the obligation" to invest. Bidders are still asked to submit bids on a fully funded basis. When will the final decision be made as to whether or not public sector equity will be taken? Is it intended that another set of shadow advisors be appointed in relation to the public equity? This could impact on timetable and introduces further potential for comments to be raised at the stage between preferred bidder and financial close.
Question 2: Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.	Such arrangements will be of benefit to the bidders if it is clear what the role of the Treasury PF2 Equity Unit is. If the bidders are uncertain as to the remit of the Treasury PF2 Equity Unit or if the Unit is not up to speed with the project, such arrangements could be confusing for bidders.

Question	Response
Question 3: Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.	
Question 4: What are your views on the following arrangements to promote new equity investors? a) Equity funding competition post appointment of preferred bidder? b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?	Both seem like reasonable ideas.
Question 5: Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.	Yes, this is the most obvious place for such working capital to come from.
Shareholders Agreement (SHA) and Articles of Association (Art) **Restriction on share transfers (SHA Clause 9 and Art 11 to 15)**	
Question 6: Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?	Yes - stapling the shares and loan stock is a way to ensure the structure of the company and shareholders' proportions are maintained. It also ensures all shareholders have the same interest in the Company rather than the different objectives that would come from holding either just shares or just loan stock.
Question 7: What are your views on the pre-emption provisions?	There are pre-emption provisions for both new allotments (shares are offered to existing Shareholders on a pro rata basis) and on a transfer or sale of shares (shares are offered to existing Shareholders other than on a pro rata basis and for the offer price proposed by the selling shareholder). This is a typical arrangement, and outside of this each Shareholder would be permitted to transfer its shares to any member of its group of companies but if the transferee ceases to be within the group then it must transfer the shares back

Question	Response
	to the transferor. There are no protections for the minority shareholders such as drag/tag along provisions. The identity of the minority shareholder will depend on the individual circumstances of each project, but is likely to be the HMTCo. This means that HMTCo cannot force the other shareholders to procure the sale of its shares to a third party purchaser in addition to theirs (tag along), and the other shareholders cannot force HMTCo to sell its shares where a third party purchaser wishes to purchase the entire issued share capital of the company (drag along). The Company may be seen as less attractive to a third party purchaser if it cannot guarantee the sale of its entire issued share capital. It would be usual to see a provision under which the shareholders can choose to waive their rights of pre-emption so as to avoid having to follow the process set out in the Shareholders' Agreement/Articles in a situation where it has been agreed that none of the Shareholders will exercise their rights of pre-emption.
Question 8: Do you agree with the event of default and deemed transfer provisions?	These provisions seem reasonable, although "Events of Default" is quite widely drafted and includes not only the type of events typically included in this definition (i.e. insolvency events, a shareholder attempting to charge, sell or transfer any of it shares or debt otherwise in accordance with the shareholders' agreement) but also where a shareholder disposes of its shares to an "Unsuitable Third Party", the definition of which includes persons whose activities are incompatible with the activities of the Company in HMTCo's opinion. This could result in a situation where HMTCo has sole discretion to decide whether or not something is an Event of Default. This should be decided by all the Shareholders (or Majority Shareholders) with the exception of the shareholder whose actions are being called into question.
Question 9: Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?	The definition seems reasonable, however the only place the term is used is in clause 9.3(a) and is not included as a defined term. This needs to be corrected.

Question	Response
Board of directors (SHA Clause 5 and Art 3 to 8)	
Question 10: What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.	This seems reasonable and it ensures each Majority Shareholder is fairly represented. However, there may be cases where one of the Majority Shareholders does not have the resources or does not desire to have more than one director on the Board even where they hold, for example, 45% of the shares and loan stock and so would be entitled to have 3 directors on the Board. In such a situation, it would be appropriate for this shareholder to have weighted voting rights at board level.
Question 11: Do you agree with the provisions relating to the chairman?	This seems reasonable.
Question 12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?	The power would mean that even though HMTCo is a minority shareholder with only one director on the board, it will have an additional representative at board level if it exercises its rights to appoint an observer. In addition, it is not easy to understand why this power would be required once HMTCo ceases to be a shareholder since arguably it no longer has an interest in the Company to protect. However, since the observer has no voting powers, and the directors can vote to exclude the observer from meetings, it is not a material concern.
Reserved matters (SHA Clause 6.2 and schedule 8)	
Question 13: Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.	B11 (sale/lease/transfer etc of whole or material part of a shareholder's undertaking in the company) and D1 (entry into contracts with shareholders) should require shareholder rather than board approval as they relate to matters concerning the shareholders. The following should also be included as Reserved Matters requiring shareholder approval as they are fundamental to protecting the company's business and structure: • The formation of any subsidiary or acquisition of shares in any

Question	Response
	company or participation in any partnership or joint venture (incorporated or not) • The amalgamation or merging with any other company or business undertaking • The acquisition or disposal of any assets of aggregate value of more than £[insert appropriate figure] or any freehold or leasehold properties • The entry into, variation or termination of any commitment by way of a transaction or series of related transactions (including without limitation any leasing transaction) which would involve the company in the payment or receipt of consideration having an aggregate value in excess of £[insert appropriate figure] • The entry into any arrangement, contract or transaction outside the normal course of its business or otherwise than on arm's length terms • The institution, settlement or compromise of any [material] legal proceedings (other than debt recovery proceedings in the ordinary course of business) instituted or threatened against the Company or submit to arbitration any dispute involving the Company B4 should be amended to include variations of any Shareholder Debt, and to cover the variation, creation, increase, re-organisation, consolidation, sub-division, conversion, reduction, redemption, repurchase, re-designation or other alteration of the share capital to ensure any such changes can only occur with shareholder consent. D1 should also be amended to include contracts with directors or any other connected persons. Others relating to areas such as IP, property, and accounting policies may be

Question	Response
	required depending on the nature of the particular project and business.
Question 14: Do you think the proposed arrangements regarding a Director's conflict of interest (SHA Clause 6.3) are practicable? If you prefer a different arrangement, please propose this and give your reasons for this preference.	These seem practicable on the whole. It would be preferable to also include provisions whereby a conflicted director can opt not to receive confidential information regarding the matter with which he is conflicted, and that he is not required to disclose information to the board relating to the conflicting matter. It would also be advisable to include a mechanism whereby the board can require a conflicted director to abstain and not receive confidential information etc.
Dispute resolution (SHA Clause 11)	
Question 15: Please give your views on the proposed dispute resolution arrangements (SHA Clause 11).	
Loan Stock Instrument	
Question 16: Do you agree that shareholder loan stock should be unsecured?	We see both secured and unsecured loan stock. The obvious advantage of having the loan stock secured is that the Noteholders would then rank ahead of the unsecured creditors of ProjectCo in an enforcement scenario. This is advantageous as it increases the likelihood of the Noteholders being repaid. However, the issue with having the loan stock secured is that any senior debt providers would not want to share their security package with the Noteholders. The Noteholders would rank behind the debt providers and have their own second ranking security package. The question would be who would act as security trustee on behalf of the Noteholders. This is a responsibility that none of the Noteholders may wish to take and having a third party security trustee could be expensive. It therefore depends on the structure of the particular transaction and the risk profile of the various parties.

Question	Response
Question 17: The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?	The costs incurred by Bidders will normally be recouped as Development Fees within the first few months of financial close, and as such Bidders should not require different rates of return to be agreed to accommodate that expenditure. However if it were the case that potentially not all Development Fees were recoverable, this would result in the Bidders taking a higher risk than the other Sponsors, and as such the Bidders could have an argument for getting a higher rate of return. If this were the case, we would advise that separate Loan Notes Instruments with varying interest rates be entered into.
Other issues	
Question 18: Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.	

Simmons & Simmons

RESPONSE TO A NEW APPROACH TO PUBLIC PRIVATE PARTNERSHIPS: CONSULTATION ON THE TERMS OF PUBLIC SECTOR EQUITY PARTICIPATION IN PF2 PROJECTS

21st AUGUST 2013

Simmons & Simmons welcomes the opportunity to respond to the consultation on a new approach to public private partnerships: the terms of public sector equity participation in PF2 projects.

Specific responses to the questions raised in the paper are set out below.

General considerations

Q.1 *Please give your observations on the proposed investment appraisal and due diligence arrangements.*

Paragraph 4.2 of the consultation document proposes that the PF2 EU wishes to avoid carrying out detailed due diligence on the complete suite of project documents. Instead it will rely on the PF2 Equity Bid Information and, before financial close, final due diligence on the equity documents (and documents between the Senior Funders and equity investors, and any restrictions on payments to equity investors) as well as a Due Diligence Memorandum from project legal advisors (with reliance for the equity investors).

We understand the rationale for avoiding detailed due diligence on the project documents that may duplicate work being done by the original equity investors, and we consider that the proposed approach will provide a significant degree of protection for the PF2 EU. However, it will also expose the PF2 EU to certain risks, for example it seems that the PF2 EU will have a limited or non-existent role in developing the content of the project documents, and will limit itself to reviewing the various information documents and reports prepared (and referring to advanced drafts of the project documents as necessary). Considering that the PF2 EU is to act as an arm's-length equity investor (with different interests to those of the procuring Authority) we think that the PF2 EU may need on some occasions to have an earlier and more detailed engagement with some or all of the project documents in order to assess accurately the risks it is considering.

Also, does "project documents" include the funding documents, and will the funding arrangements be covered by the various memoranda and reports being prepared? We consider that, to the extent that there is certainty as to the proposed funding arrangements, these should be covered by the same due diligence relationships.

We understand from the proposed process that the PF2 EU is not intending to propose amendments to, or take an active role in shaping, the project documents (or funding documents) and will effectively make an investment decision on the documents as they are. Is this correct? If so the PF2 EU may need to consider what protections should be required from the original equity investors in respect of risks that may arise from the project documents that the other equity investors have negotiated. We anticipate that the original equity investors may be resistant to this.

Paragraph 2.4 of the consultation document notes that the equity investor documentation will need to be revised for each transaction. It is not clear from the process in section 4 if and when the PF2 EU intends to input into the tailoring of the equity documentation. Will the PF2 EU want to input actively into the tailoring of the equity documentation? If so, when will it anticipate doing this? The later in the process this is done, the less scope there may be for effective input. Again, effective review of and commenting on the equity documentation may require earlier and more detailed engagement with the project documents.

We note that to protect its position the PF2 EU is seeking various rights against project advisers, and potentially from the Senior Funders' insurance and technical advisers. We understand the rationale for this, given the stage at which the PF2 EU intends to come in as an equity investor (if it does at all) and its wish to limit the amount of due diligence. We note that obtaining such rights may involve negotiation with the respective advisers regarding the scope of the reliance, extent of assumptions and qualifications and the effect on any limit of liability. Also, we note that in practice the reliance letter approach may only provide limited protection to the PF2 EU (e.g.

where the original equity investors were informed of a risk but chose to accept it in order to make their bid more competitive, or where the focus is on Senior Funders' position, rather than that of equity investors). The PF2 EU should bear these factors in mind when assessing how much comfort it can take from the proposed letters of reliance.

Q.2 *Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.*

Yes, informal guidance from the PF2 EU will undoubtedly be of benefit to bidders during, and separately from, the procurement process. We presume that the process for seeking and giving such guidance will respect the principles of equality of information, non-discrimination and transparency and will therefore be shared with all bidders, but without disclosure of the identity of the bidder seeking the guidance.

Q.3 *Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.*

The information listed in Schedule 7 is reasonable information for a shareholder to expect to receive in respect of a joint venture company. What is different in this case from a normal JV situation is that the information may be disclosed by HMT under the provisions of clause 8.5, rather than being covered by the confidentiality provisions of the shareholders agreement. The Government's commitment to achieve greater transparency in PF2 projects is understood. However, what is more difficult to understand is the logic for clause 8.4 (c), which permits the HMT to receive (and presumably to publish) the Transparency Information even after it ceases to be a shareholder. Please see further our comments below in relation to question 12, where similar issues arise in the context of appointment of an observer. If the concern is to ensure public access to this information, irrespective of the Government's shareholding in the Project, why not make appropriate provision in the Project Agreement?

Q.4 *What are your views on the following arrangements to promote new equity investors?*

a) Equity funding competition post appointment of preferred bidder?

It would be helpful to understand the circumstances in which bidders will be advised that an equity funding competition is to take place. A third party equity provider (TPE) may add significant value by being involved at the outset in consortium with the Developer. Will an equity funding competition still be required if the preferred bidder already has in place a TPE?

b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?

This seems to us to be sensible to give HMTCo the flexibility to subscribe for a higher equity stake at financial close and later sell down during the Lock-In Period. Will the early sell-down be allowed for only a specified proportion? Is it intended that HMTCo will retain a proportion of its original equity investment so as to preserve the principle that the shareholders invest on the same terms?

Q.5 *Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.*

We think it is reasonable for the Developer to provide this facility, provided the loan is on an arms-length basis and the rate of return is based upon the credit rating/strength of the borrower and not the Developer. Of course, this may affect the equity return to the government as a shareholder in the ProjectCo, but only in circumstances where the new money invested doesn't lead to a revenue-producing asset.

Shareholders Agreement (SHA) and Articles of Association (Art)

Restriction on share transfers (SHA Clause 9 and Art 11 to 15)

Q.6 *Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?*

Yes.

Q.7 *What are your views on the pre-emption provisions?*

In relation to Article 13.4, determination of the Sale Price will default to the Proposed Sale Price in the absence of agreement between the Vendor and the Board. This price would be determined by the Vendor and proposed purchaser (if any). A possible alternative would be to make the Sale Price the Market Value (as is done for Compulsory Transfers).

In relation to Articles 13.5 to 13.9, instead of having a single Offer Notice and offer period, there could be two rounds - a first offer period and a second offer period. The purpose of a second offer period would be that where the Shareholders other than the Vendor had not applied for the total number of Sale Shares, they could be given a second opportunity to do so, which could be an additional 14 day period. The current 14 day period of the Offer Notice (Article 13.6(b)) is relatively short, but if this is a deliberate decision perhaps a second offer period should not be included.

The Articles could specify that after an offer period the Board would allocate the Sale Shares to a non-Vendor Shareholder in the proportion that their existing holdings bear to the total number of shares held by all non-Vendor Shareholders who had applied for Sale Shares, up to the maximum of the number of Sale Shares for which the non-Vendor Shareholder had applied. Fractional holdings would be rounded and any remainder allocated as the board saw fit (as per Article 13.8(a)).

It is worth specifying how the Board will allocate the Sale Shares should the applications for Sale Shares from the non-Vendor Shareholders exceed the number of Sale Shares. Article 13.8 only says that the Board shall allocate the Sale Shares in accordance with the applications received. The allocation could be pro-rata to existing shareholdings (up to a maximum of the number of shares applied for by each Shareholder).

Q.8 *Do you agree with the event of default and deemed transfer provisions?*

The warranties could include warranties as to compliance with relevant anti-corruption laws, including the Bribery Act 2010. Breach of these warranties would be an Event of Default under the Shareholders' Agreement, as breach of the warranties is an Event of Default in the Shareholders' Agreement as currently drafted. It would also be possible to include breach of anti-corruption legislation as a Transfer Event in the articles.

Conviction of criminal offences could be included in the Events of Default in the Shareholders' Agreement. This is not explicitly covered by the Unsuitable Third Party definition as drafted. It would also be possible to include conviction of criminal offences as a Transfer Event in the Articles.

It may be better to specify in Article 14.4 exactly which provisions of Article 13 do or do not apply to deemed transfer notices in Article 14. For example, Article 13.12 should apply. It may also be better to specify that Article 13.11 does not apply in the event of a Deemed Transfer, given that the effect of clause 9.4 of the shareholders' agreement is that the vendor would not be able to sell to a third party of their choice in the event of a deemed transfer notice.

Q.9 *Do you have any comments on the definition of "Market Value" and the manner in which this will be determined?*

No.

Board of directors (SHA Clause 5 and Art 3 to 8)

Q.10 *What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give reasons why you regard this as preferable.*

Under Article 4.3 a director can abstain from voting or participating in a meeting where he considers that to vote for or against a matter may put him in breach of his duties to the Company and that if he does so he is not then in breach of his statutory duties as a director. We do not think this article is necessary or suitable.

There are various references in the Articles to "Majority Shareholder" which should be to "Material Shareholder".

Otherwise, the proposed arrangement for nominations and composition of the Board seem practical. However, we would suggest including a notice requirement to the other Shareholders on the nomination or removal of a director.

Q.11 *Do you agree with the provisions relating to the chairman?*

We note that under Clause 5.4(b) of the Shareholders' Agreement an independent non-executive Chairman, if appointed, would not have a vote. Whilst we appreciate the significance of giving an independent Chairman a vote we think the presumption should be that an independent non-executive Chairman should have a vote (and furthermore a casting vote). We think that this presumption will be more likely to attract a better calibre of Chairman (because there is a more meaningful role) and having a vote will enhance the role and effectiveness of that independent non-executive Chairman.

Q.12 *Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?*

We have no objections to the proposed arrangements for HMTCo to nominate or remove an observer while HMTCo holds minority shares in the Company. The scope of the proposed observers' rights reflects good practice; the observer usually has no voting rights, but has rights to speak and contribute at board meetings. The observer is also subject to confidentiality undertakings, and may be excluded from meetings or from viewing documents, should the Board decide.

What is more unusual is HMTCo retaining a right to appoint an observer when it no longer holds shares in the Company. The right to appoint a board observer is primarily a means of minority shareholder protection, designed to keep minority shareholders informed of board decisions. If HMTCo is no longer a shareholder, it may be difficult to justify retaining this right. HMTCo could argue that its board observer would be valuable in guiding the Company's board in coming to its decisions on local issues but this can be done without needing to appoint an observer or by leaving it to the board's discretion as to whether and who to appoint as an observer or an adviser.

Also, other parties may require HMTCo to include wording seeking their approval when nominating or removing a board observer or adviser.

Reserved Matters (SHA Clause 6.2 and schedule 8)

Q.13 *Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons and explanation for your views.*

Material transactions involving more than a specified value could be included in the list of Reserved Matters in Schedule 8 requiring either board or shareholder approval. This is not currently in the list. This would be more relevant to the SPV, but could apply to the HoldCo as well.

While change of name of the company (B6) can be made a board reserved matter, changing the name of the company will require shareholder approval. Under the Companies Act 2006 s.77 a company can only change its name by shareholder resolution or by means provided for by the Articles, and the Articles do not currently provide for the board to change the company's name.

Q.14 *Do you think the proposed arrangements regarding a Director's conflict of interest (SHA Clause 6.3) are practicable? If you prefer a different arrangement, please propose this and give your reasons for this preference.*

Our preference is clearly to distinguish between decisions taken at a board level and at a shareholder level. So our preference would not be to include Clause 6.3 (a) - (d).

Furthermore and excluding the step-aside provisions in Clause 6.5, Clause 6.3(d) materially increases the influence of the relevant Material Shareholder at the board level in a conflict situation and may contribute to an assessment that the Material Shareholder controls the Company/SPV, depending on other factors.

Clause 6.3 (d) does not appear to add anything substantial to the clause.

Dispute Resolution (SHA Clause 11)

Q.15 *Please give your views on the proposed dispute resolution arrangements (SHA Clause 11).*

One option would be the ability to propose a binding expert, mediation or arbitration, with arbitration as the fall back.

Loan Stock Instrument

Q.16 *Do you agree that shareholder loan stock should be unsecured?*

It has typically been unsecured in projects where there are no meaningful third party creditors, as well as for cost reasons. However there is no reason why it should not be secured if desired, provided the security is properly second ranking. The cost is an issue and lenders are rightly wary of their Security Trustee holding security for both senior debt and sub-debt so a separate security trustee needs to be appointed and take second ranking security. The added cost and complexity is usually deemed not to be worth it.

Q.17 *The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?*

We agree with the principle that the risk borne by the bidder should be rewarded. Having different rates achieves this, but this could be complex to structure. A different, and easier, way to do this would be to reflect it in the price of the equity.

Other issues

Q.18 *Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.*

There are no provisions for HoldCo and the SPV to comply with the Bribery Act and to maintain adequate procedures, as there should be.

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Date: 21 August 2013

SKANSKA

HMT Consultation on the terms of public sector equity participation in PF2 projects – July/ August 2013

General considerations

Q1: **Please give your observations on the proposed investment appraisal and due diligence arrangements.**

From our perspective as both an investor in, and constructor of PPP deals, the issue of either public sector, or third party equity participation in PF2 projects comes down to clarity, timing and the appropriate balance of risk and reward. At the initial bid/ no bid appraisal stage, the proportion of private sector equity to public or third party equity is key to understanding the deal from an investment perspective, based on cost to bid and projected return on investment.

It is typical for many construction companies active in the PPP market to fix their equity participation between 40% and 50% to provide an acceptable balance of investment return to the costs of bidding. Assuming a maximum public sector equity contribution of 25% – 30% this leaves a relatively small equity stake available, either as part of the bid consortium or to be offered to the market via a third party funding competition. The question becomes whether the project is of sufficient scale for this equity to be sufficiently attractive to institutional or 'non-trade' investors.

We note that the requirement for bidders to provide a 'fully funded solution' is potentially problematic in the context of uncertainty as to whether HMTCo will or will not fund. If there is an equity funding competition and HMTCo elects not to fund, this tranche could, as a simple solution, be added to the equity to be competed and/or offered to the original sponsors. However, depending on the timing of the election (unclear at present how close to financial close this election could be made), a late change is likely to add cost and delay to the financial close process.

In the event that no equity funding competition is envisaged, it is inherently unattractive for both construction and third party investors to put forward investment cases that involve considerable uncertainty as to the absolute capital commitment that may be called on. Investment cases would necessarily focus on the core investment opportunity, so the issue of scale, raised above, remains.

We are assuming that the equity to be competed is excluded from the 'fully funded' requirement: if this equity element must also be underwritten then the difficulty in securing such committed funds from institutional investors in particular will be compounded, given the very high level of 'contingent' requirement. This is similar to the accepted difficulty in getting banks to commit to due diligence and credit process required for full bid funding commitment if they know that this debt commitment will be competed post bid.

Our base assumption would be that all equity investors bear their own cost of participation in the project and are responsible for undertaking their own due diligence as a development cost offset against potential future returns. If equity participation by the public sector changes late in the day (e.g. post preferred bidder appointment) we would expect any reasonable additional costs associated with revisions to the funding and financial close process to be recoverable via adjustments to the financial close model.

Q2: **Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately to the Authority.**

A similar procedure was adopted on the Building Schools for the Future programme where we have experience of engaging with BSFI in parallel to the procuring Authority. We found this to be constructive and recognise that undertaking this in parallel to the primary procurement dialogue allowed all parties to secure sufficient clarity early in the process. We would note that if the procedure becomes unduly prescriptive it will only add cost to all parties.

In terms of timing, we would request that these discussions take place well in advance of financial close as understanding the tax structure of the equity and HMT Co could have real commercial implications.

Q3: **Do you have any objections to disclosure of Transparency Information? Please give reasons for any objections.**

If the premise is that the PF2 model has been designed to encourage wider investment in UK infrastructure by individuals and companies who have previously not seen this as an attractive market, then we would query whether unbounded disclosure of information will support this goal, or create an additional barrier to participation. Previously the provisions of the Freedom of Information Act have provided some level of comfort that reasonable commercial confidentiality would be respected but in this instance there is no limit on the extent of information which HMT can disclose to the relevant Authority which would potentially cut across legal privilege, for example in the event of a dispute.

As a shareholder in the project, HMT Co should receive information, in line with other shareholders, that allows it to discharge its obligations to the project and ensure that the interests of Project Co are protected. However, once HMT Co is no longer a shareholder in the project we would question whether this continues to be appropriate.

In terms of the proposed timescales, we note the target response dates for provision of the information: are these intended to be 'hard' targets or 'reasonable endeavours', as there may be circumstances out of the control of the SPV or the Company which result in these targets not being met.

We believe item B3, which relates to the terms of disposal of Shares or Shareholder Debt, should not be given until after any disposal has been completed, as this could have an impact on the ability to secure true market value. In addition, we do not believe that IntraGroup transfers should be disclosable, this clause should only be triggered by a sale outside the group.

Q4: What are your views on the following arrangements to promote new equity investors?

a) Equity funding competition post appointment of preferred bidder?

We assume that the intention is to follow the procedure set out in Section 6 to this consultation document to obtain the most economical advantageous position. We believe the procedure set out is reasonable and would only note that sufficient time should be allowed within the project timetable, particularly if the HMT 18 month limit on the procurement process is to be applied.

The documents, as currently drafted, do not make it clear whether a third part equity funding competition post preferred bidder appointment would still be required in the event that a third party provider was part of the bidding consortium from the outset of the procurement. In our view, if this was the case, effectively the equity would already have been tested in the market and hence further competition should not be necessary.

b) Reduction in HMT Co equity post financial close (either during the Lock In Period or thereafter)?

In the spirit of fairness and transparency the rules governing all Change of Control provisions (Funding Documents and Project Agreement) should apply equally to all equity investors.

Q5: **Where is a reasonable expectation that Project Co will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not please explain your position.**

If the HMT Co holding is at de minimis level, i.e. 15% or less, the position is acceptable. In order to align interests and to reflect an equitable risk/ reward structure we suggest that all shareholders with an interest of 15% or more should contribute working capital in proportion to their shareholding.

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Q6: **Do you agree that shares and loan stock should be stapled so they cannot be sold separately (except with the consent of all other shareholders)?**

There are still tax/legal concerns regarding the structure and the methodology used to staple loan stock and equity with the ultimate risk that loan note interest will no longer be tax deductible. On this basis we do not think it is necessary, nor prudent, for stapling to happen. However, if the public sector wishes to insist on stapling then the private sector should be indemnified against any future losses arising from this position.

Q7: **What are your views on the pre-emption provisions?**

Our experience of divestment of equity stakes in PPP projects suggests that pre-emption clauses can be to the detriment of competition and can restrict the ability of the shareholder to achieve best value (including the Public Sector). On this basis we do not believe that pre-emption clauses should be included.

Q8: **Do you agree with the event of default and deemed transfer provisions?**

A general issue here is that loss of equity for event of default at par is not a current market position. We consider that dis-enfranchisement of shareholder rights unless and until the relevant breach is resolved is a more balanced solution.

The events of default, as defined, are wider than we would currently expect to see. For example, item (e). There may be circumstances where change in ownership, or business focus, of a Shareholder (especially if that Shareholder is a private company) is out of the control of the SPV representatives and as a result we do not think it appropriate that this should be considered as a default event at project level. An alternate position could be that the Shareholder in question is required to divest their interest.

With regards the timing of the remedy period we suggest that the remedy period should only commence on being aware of the default and should not be retrospectively applied as this can result in disproportionate remedies being applied.

We would also expect to see a discount being applied to the price in the event of default leading to a deemed transfer and do not see the need for the concept of an “Agreed Price” clause 13.11 (A of A).

Q9: **Do you have any comments on the definition of "Market Value" and the manner in which this will be determined?**

The principle of the definition and the manner in which it is to be determined are acceptable but we would welcome additional detail on how this will be managed in practice. Unless there is an actual sale this can only ever be a theoretical exercise based on a range of opinions and base assumptions. Should the 'Market Value' be based on the range of for example, three, independent advisors each providing a most likely, best and worst case appraisal which could be used as the basis for an average Market Value?

Q10: What are your views on the proposed arrangements for nomination and composition of the board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.

It must be clear that HMT Co is conflicted with respect to any dispute/action to be taken against the client.

The provisions to disenfranchise directors from voting apply at a much earlier stage than is typically the case: ordinarily, dis-enfranchisement only applies for actual or contemplated enforcement or litigation, rather than where a claim is "asserted" and is still being commercially resolved.

Q11: Do you agree the provisions relating to the chairman?

The proposal is fine. However, if the choice is for an independent chair to be appointed, this will result in additional overheads being incurred, which should be reflected in the unitary charge, as the choice may be influenced by the outcome of the equity funding competition

Q12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?

No. We have experience of this in practice on the Building Schools for the Future Local Education Partnerships and the M25 PPP, where the Highways Agency has an observer, and it works well.

Q13: Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.

The principle should be that the Shareholders Agreement is complementary to the Project Agreement and funding documents and should not cut across or duplicate. On that basis we believe that item B11 should be deleted.

In order to ensure routine matters can be discharged efficiently our preference would be for items C8 and D1 to be addressed in the Shareholders Agreement rather than requiring additional approval each time. We also suggest that Note 25 is extended to cater for secondment agreements.

It is unusual for all Reserved Matters to require unanimous consent. Ultimately, the percentage thresholds are determined by the actual shareholding on a case by case basis, but it would be unusual for a minority shareholder to have full veto rights over the complete list of Reserved Matters you have provided – a lower threshold for non-fundamental matters is common.

Q14: Do you think the proposed arrangements regarding a Director's conflict of interest (SHA cl 6.3) are practicable? If you prefer a different arrangement please propose this and give your reasons for this preference.

Our assumption is that this provision deals with the conflict of interest as between the Shareholder and the SPV rather than arising because of another group interest, for example, a dispute with the contractor. These provisions are new; there has never been an express requirement to put the interests of the SPV first. Is it the concern that the Shareholder would reach a different decision from the Director? In our opinion the general provision to "generally act in a manner that will promote the Businesses and the interests of Holdco, IntermediateCo and DBFO Co and act in good faith towards the other Shareholders" has worked well in practice and is well understood by the market.

The step aside provisions are too onerous, although the conflicted director should not be allowed a vote they should be entitled to be involved in the discussion, to understand the issues and implications and to enable all views and positions to be aired. These provisions also need to capture HMT Co as there could easily be a conflict of interest if a dispute occurs between the Client and the SPV.

Q15: Please give your views on the proposed dispute resolution arrangements (SHA Cl 11).

In principle we accept the proposed dispute resolution arrangements, however we would suggest there are provisions to facilitate such decisions as necessary to allow the project to proceed without breach of the Project Agreement.

Q16: Do you agree that shareholder stock should be unsecured?

Yes. However the option for shareholder stock to be secured but junior to senior / mezzanine debt should be allowed as well to maximise flexibility to provide the most economically advantageous funding solution.

Q17: The Bidder incurs costs and risk in bidding in a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?

The most straightforward arrangement is that the Bidder is entitled to recover a success/development fee to reflect the additional risk. Failing that there could be different classes of shares which have different entitlement to dividends (note all shares are the same with the same rights in the documentation). Loan stock is more of a problem in terms of demonstrating an arm's length approach. We would need HMRC sign off that the higher rate was arms length. This is not ideal as we would run the risk that the sub debt interest is not tax allowable. It is difficult to argue that the same directors of the company would lend to it at differing rates if the shareholder stock rank equally.

Q18: Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.

We question whether it is appropriate for HMT, as a minority stakeholder, to issue a standard form suite of documentation when each bidding company, or consortia, would have existing, and preferred, approaches. Our preference would be for HMT Co to provide for its minority rights on a project by project basis.

Should HMT wish to proceed on the basis of standard form documents there are a number of subsidiary points associated with the proposed drafting which we believe would benefit from a discussion on a project by project basis. For example, we believe that the Shareholder Agreement should be used as a template, rather than mandatory document, to ensure that it may be refined to reflect project specific issues.

The Additional Provisions drafting should be clarified to ensure that anyone acquiring HMT Co's shares does not acquire those rights to the extent that they are different from those of other shareholders.

Public Equity in PF2 Projects Consultation

Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements?

It is imperative that the equity investment appraisal is conducted independently of the procurement of the project. Research commissioned by RICS on the PF2 model has consulted widely with the institutional investment community with the overwhelming view that these processes need to be at 'arms-length' as to avoid potential conflicts of interest. However, one of the major criticisms of the PFI model in the UK has been the time required to get deals to financial close. It is only right that robust and thorough due diligence is undertaken given the magnitude of the investment and the repayment timeline as well as to ensure VFM on the part of tax payers. Nonetheless the procurement process is already considered by many stakeholders to be lengthy and overly bureaucratic - it is imperative that the new layers of investment appraisal and due diligence do not further extenuate project timelines nor indeed should the appraisal processes be so lengthy, complex and cumbersome so as to discourage investor interest.

Question 2: Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.

To the extent that 'equity share' is in essence a 'new' form of financial structure for PPP such dialogue and discussions will provide useful insight and direction as well as focussing bidder attention on the risk dynamics of the project – this is already done to a great or lesser degree with existing PPP financial/investment stakeholders. It is also important to recognise that this is it is an area of the process that the procuring authority is not in a position to advise on.

Question 3: Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.
N/A

Question 4: What are your views on the following arrangements to promote new equity investors?

a) Equity funding competition post appointment of preferred bidder?

RICS commissioned research on the 'appeal' of the bidding process amongst institutional investors was a very mixed bag. A number of the fund managers interviewed did not have a problem with the concept and considered it to be a fair and reasonable way of attracting investors. There was an overwhelming need for the process to be as transparent as possible to ensure investors did not loss confidence in the process. A number of fund managers however pointed to a potential lack of appetite amongst investors for such a process – 'how many institutional funds really want to invest in PPP?' Will they be willing to undertake the ‘preparatory works’ involved in the bid submission process only to be told they have been unsuccessful? A full and comprehensive insight on fund manger views will be provided as part of the imminent dissemination of the RICS commissioned research on PPP.

b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?

Reduction of the HMTCo equity during the ‘lock-in’ period would surely be a contradiction in terms. A number of fund managers expressed a lack of desire to invest with government on an equity share basis – it would appear that more work needs to be done to convince the wider institutional investment community on the virtues/benefits of being part of a equity share investment model. The case for de-risking the project by having a long-term equity stake on the part of government may appease/appeal to some investors but certainly not to many of the fund managers consulted during the RICS research. Therefore if the ‘terms’ under which the government would invest were seen to be in any way ‘favourable’ to that of institutions then this will detract from the appeal.

Question 5: Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.

In the interests of ‘simplifying’ as far as is practically possible the financial model then working capital should be provide by the developer. The developer should have a vested financial interest in the project and due diligence and scrutiny of the bid would determine the financial wherewithal and working capital capacity of the developer prior to commencement.

Shareholders Agreement (SHA) and Articles of Association (Art) Restriction on share transfers (SHA Clause 9 and Art 11 to 15)

Question 6: Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?

This is the most logical approach in terms of how the proposed model has been structured – it serves to remove some of the ‘flexibility’ and ‘liquidity’ of such investment frameworks but investors should view the model as a long-term commitment from the outset.

Question 7: What are your views on the pre-emption provisions?

The pre-emption provision would be considered ‘normal’ in this type of investment framework. It is right and proper that the pre-emption clause is retained to enable ‘primary’ investors the opportunity to increase their stake in the company prior to opening up opportunities to the wider market. The fact that shares can be traded in the open market offers incentive from a liquidity perspective whilst affording exposure to the infrastructure asset class. As previously discussed there are pros and cons on government wishing to dilute their stake in the company.

Question 8: Do you agree with the event of default and deemed transfer provisions?

Such provisions are customary but from an investor perspective this would be considered and factored into the pricing of risk as in effect investors are not only undertaking due diligence on the project but on the solvency (or otherwise) of fellow shareholders – given the institutional investment community being targeted the probability of default is 'marginal'. Investor composition (as well as project credentials) is likely to be important in determining the attractiveness of opportunities.

Question 9: Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?

Open market trading is the optimum means to determine 'value' and with shares being permitted to be traded it is probable that a 'secondary' market will emerge. In the absence of 'market' evidence it may be necessary to appoint an independent third party.

Board of directors (SHA Clause 5 and Art 3 to 8)
Question 10: What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.

The arrangement as proposed seems reasonable – it is important in terms of the attractiveness of becoming involved from an investor perspective that they have a voice on the board that has equal footing with other shareholders. The arrangements are flexible enough to conform to different board compositions and structures.

Question 11: Do you agree with the provisions relating to the chairman?

It is right that the chairman in a structure of this nature should not have the casting vote – particularly if chairmanship is going to be rotated. The option to appoint a non-executive independent chairman permits flexibility in the Board Room structure if necessary and for the purposes of continuity and impartiality may prove an attractive.

Question 12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?

The observer role seems reasonable given they have no voting rights and can be excluded from meetings on the basis of a majority vote. It is probable that challenges will be made about the retention of the 'observer' if government has dissolved its equity stake in the company.

Loan Stock Instrument

Question 16: Do you agree that shareholder loan stock should be unsecured?

Not necessarily as this will have implications in terms of costs – more detail required in terms of the risk-reward proposition.

Question 17: The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?

Ideally, there needs to be some form of 'incentivisation' in the form of return for those involved in and incurring the 'risk' and costs of the bidding process. A higher rate of interest on loan stock is potentially one means of 'rewarding' the additional risk incurred but not the most appropriate**.** Currently there is no recovery of bid costs and these are undertaken 'at risk' – although this has been prohibitive to market entrants in some cases. At present bid cost are recovered through successful PPP bids with developers seeking a win ratio of 1:3.

Other issues

Question 18: Please comment on any other matter which you regard as important in connection with equity investment in PF2 projects by the public sector.

RICS has commissioned research on the global PPP market. As part of that process the research teams from the University of Aberdeen and University of Ulster have engaged in a series of interviews with the institutional investment community in the UK. That research has specifically considered the need to attract enhanced levels of institutional investment into the PPP sector. The views conveyed in these answers reflect the views of the research team at the Universities of Ulster and Aberdeen in collaboration with the Royal Institution of Chartered Surveyors (RICS). The research report will be launched in London on 30th October 2013.

HM Treasury

VINCI CONCESSIONS

A new approach to public private partnerships:

Consultation on the terms of public sector equity participation in PF2 projects

From:

VINCI Concessions SAS/UK

9, Place de l'Europe

92851 Rueil Malmaison Cedex

To:

PPP Policy Team

HM Treasury,

1, Horse Guards Road,

London

SW1A 2HQ

Email: PF2equity@hmtreasury.gsi.gov.uk

Wednesday 21 August 2013,

Dear Sir or Madam,

As requested in the consultation document put online on your website on Wednesday 10 July 2013, please find in this document our responses to the questions gathered in the Chapter 7.

We remain at your disposal should you need any additional information.

Yours Sincerely,

Laurence DHOMME

Area Director Europe, VINCI Concessions SAS

General considerations

Question 1: ***Please give your observations on the proposed investment appraisal and due diligence arrangements?***

For more than 20 years, it is undeniable that PFIs have proven to be efficient for the delivery of public utilities, infrastructure and services. Among other things, they make it possible to foresee the whole life cycle of assets; they have stimulated investment, innovations, and have spread a certain culture of performance in the public sphere. Nonetheless, some projects faced difficulties and issues have been raised by the Public Authority.
We understand that some clarifications are necessary to implement the proposed investment appraisal and due diligence efficiently. It is crucial that the conditions of project eligibility to public equity are clarified upstream. The bidders must know from the outset of the procurement proceeding whether or not public sector wishes to invest equity in a project, how much it may invest and under which conditions. The amount and the identity of the Parties participating to equity is part of the overall bidding strategy. Being informed of a public participation during the procurement would weaken the agreements between the private partners and the role of public sector as a shareholder has to be addressed.

Question 2: ***Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? This would be carried out separately from dialogue with the Authority.***

It is not clear to us what the "informal public sector equity guidance arrangements" is sand in what circumstances bidders could be allowed to request. It is critically important that the same information is provided to all bidders. In order to avoid asymmetric information issues, it would be relevant to know in advance, at the beginning of the competitive tender, whether (and by which amount) the public sector would participate as equity provider.

Question 3: ***Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.***

We do not object to the disclosure of the Transparency Information to the Shareholders of the HoldCo and the ProjectCo to the extent that it is necessary for the Shareholders to monitor the fulfillment of the HoldCo and the ProjectCo's obligations under the Project Agreements.

However, we strongly object to the disclosure of the Transparency Information to HMTCo if it is not or ceases to be a Shareholder. In such cases, the extent and nature of the information relating to the Project to be provided by HoldCo and the ProjectCo to public entities shall be agreed in the Project Agreements or derive from the law.

In the case that HMTCo is a Shareholder and therefore has access to the Transparency Information, we agree that it discloses the Transparency Information pursuant to Article 8.4 (b) (ii) of the Shareholders' Agreement PROVIDED THAT:

(i) the disclosure is made to government or public bodies, not to private entities,

(ii) the other Shareholders, the HoldCo and the ProjectCo, as the case may be, are informed about such disclosure before it is carried out,

(iii) such disclosure has the only purpose of permitting government authorities or public bodies to prepare an annual report on the public sector's investment,

(iv) The Shareholders, the HoldCo and the ProjectCo, as the case may be, shall have the right to object to such disclosure if the aforementioned requirements are not fulfilled.

Finally, we understand that the provisions of Article 8.4 (b) (ii) suffice to ensure the transparency of the HoldCo's and the ProjectCo´s activities and to provide government or public bodies with all elements they may need to assess the performance of the Project. The additional prerogatives that Article 8.4 (b) (iii) gives to HMTCo do not enhance its or other public bodies' ability to reach such purposes. On the other hand, Article 8.4 (b) (iii) imposes a disproportionate constraint on the HoldCo and the ProjectCo, since they will have to provide copies of its records to any person authorized by HMTCo to such effect. In light of this, we recommend that Article 8.4 (b) (iii) be deleted.

Question 4: ***What are your views on the following arrangements to promote new equity investors?***

a) Equity funding competition post appointment of preferred bidder?

Equity parameters are specific to each competitor and part of the bidding strategy. It is one of the cornerstones of the agreements settled between partners. Modifications of the equity structure after appointment of preferred bidder would alter the credibility of such agreements. We therefore believe equity funding competition should not be an obligation.

b) Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?

In theory, we consider this possibility as an attractive option. However, in practice, it is not sure that HMTCo equity for financial close, followed by the possibility of reduction of such equity after financial close (or during lock-in period) would make financial close easier. All the consequences for lenders of such an equity reduction (sold to other equity providers) would have to be foreseen in relevant agreements.

Question 5: ***Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? If not, please explain your position.***

We believe that any financing needs or guarantees of any kind required by lenders should be provided by all shareholders *pro rata* their participation interest in the share capital of the HoldCo and/or the ProjectCo, provided that non-recourse bank debt is unavailable.

Shareholders Agreement (SHA) and Articles of Association (Art)

Restriction on share transfers (SHA Clause 9 and Art 11 to 15)

Question 6: ***Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)?***

Yes, we agree in principle with this provision.

Question 7: ***What are your views on the pre-emption provisions?***

We agree with the pre-emption rights of the Shareholders set forth in Article 13 of the draft Articles of Association of the HoldCo.
However, we understand that Selling Shareholder should only be able to serve a Transfer Notice to the Company in case it receives a legally binding offer from or makes a legally binding offer to a third party for the acquisition of the Sale Shares. The conditions of the purchase of the Sale Shares by any Shareholder exercising its pre-emption rights should not be less favorable as those stipulated in the legally binding offer received/made by the Selling Shareholder and the identity of the third party making/accepting the offer to purchase the Sale Shares should be disclosed in the Transfer Notice. In our opinion, this mechanism would ensure that the shares purchase is undertaken "at arm's length" and avoid speculation on the Share Price.

Question 8: ***Do you agree with the event of default and deemed transfer provisions?***

Yes, we agree in principle with such provisions.

Question 9: ***Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined?***

No, we have no further comments in this regard.

Board of directors (SHA Clause 5 and Art 3 to 8)

Question 10: ***What are your views on the proposed arrangements for nomination and composition of the Board of directors? If you disagree with this proposal, please suggest an alternative structure and give the reasons why you regard this as preferable.***

We agree in principle with the arrangements for nomination and composition of the board of directors. Although we believe that a 15% participation in the share capital is a reasonable threshold for a Shareholder to be able to appoint a director, we suggest that such percentage be subject to adjustment depending on the number of Founder Shareholders.

Question 11: ***Do you agree with the provisions relating to the chairman?***

We agree with the provisions relating to the appointment of an independent non-executive Chairman insofar as they are not mandatory.

Question 12: ***Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter?***

If the purpose of appointing an "observer" is to ensure transparency, we believe that the disclosure of the Transparency Information pursuant to Article 8.4 of the Shareholders' Agreement suffices for HMTCo to gather information relating to the activities of the HoldCo and the ProjectCo. As a result, the presence of an observer at the board would represent a disproportioned constraint with no practical reason.

On the other hand, if the purpose of appointing an "observer" is to enhance the dialogue and interaction between the public sector and the shareholders before important decisions are taken, we believe that the creation of "network boards", which are a common practice in PFIs, is far more effective to reach such purpose than the presence of "observer".

In any event, if HMTCo is a Material Shareholder, it will have the right to appoint directors to the board and therefore take part on the decisions. On the other hand, if HMTCo is not or ceases to be a Shareholder, any rights that the public sector may have with regard to the project should be set forth in the Project Agreements, not in the Shareholders' Agreement, which shall cease to be applicable to HMTCo. In both cases, we object to the presence of a board observer.

Reserved matters (SHA Clause 6.2 and schedule 8)

Question 13: ***Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons an explanation for your views.***

We do not have specific objection to the list of reserved matters. However, we believe that such list and the provisions of Article 6.2 of the Shareholders' Agreement should be subject to review and adjustments, on a case-by-case basis, depending on the number of Shareholders and Material Shareholders that the HoldCo and the ProjectCo will have.

Question 14: ***Do you think the proposed arrangements regarding a Director's conflict of interest (SHA Clause 6.3) are practicable? If you prefer a different arrangement, please propose this and give your reasons for this preference.***

We think the arrangements regarding the Directors' conflict of interest set forth in Article 6.3 are practicable.
However, we strongly object to the step-aside provisions set forth in Article 6.5. Directors are bound by the fiduciary duties they owe to the Company and therefore, unless they breach such duties, they cannot be deemed to have an interest conflicting with the Company's interest which should prevent

them from voting when the interests of the shareholder who appointed them or of the Associates of such shareholder conflict with the interest of the Company.

As a result, we understand that if any Claim is put forward by the Company against the Developer or one of its Associates, or *vice-versa,* the directors appointed by the Developer should not step aside from the discussions and voting relating to such matter. In the event that these directors breach their fiduciary duties in such circumstances, the matter shall be resolved in accordance with the terms of Article 11.

Dispute resolution (SHA Clause 11)

Question 15: ***Please give your views on the proposed dispute resolution arrangements (SHA, Clause 11).***

Clause 11 sets forth that if a disagreement or dispute arising out or in connection with the Shareholders' Agreement ("Dispute"), the parties shall use their reasonable endeavors to resolve the matter on an amicable basis. In case the parties fail to resolve the disputes amicably by the end of the "Second Consideration Period" a "Deadlocks" is deemed to exist and the dispute shall be submitted to a *third party expert.*

We believe that expert determination is a suitable ADR proceeding to resolve technical or valuation disputes where an industry expert is a more appropriate decision maker than a judge or arbitrator. The expert shall not act as an arbitrator and therefore his/her role is more focus on assessing facts rather than interpreting the contractual provisions and/or the law.

However, many disputes arising out or in connection with shareholders´ agreements transcend the limits of a technical assessment and require a legal analysis of the parties' rights and obligations (sometimes including a consideration of the parties' good faith). Expert determination would hardly be seen as the correct forum for those disputes.

As a result, we suggest that, rather than being applicable to any and all "Deadlocks" that may arise in relation to the Shareholders' Agreement (as set forth in Clause 11.2), expert determination be used to resolve Deadlocks relating to technical matters, such as the market valuation of the Defaulting Shareholders Debt pursuant to Clause 9.3 of the Shareholders Agreement or to determine any breach of a director´s fiduciary duties in case of Article 6.3.

Furthermore, depending on the technical nature of the Deadlock, the Institute of Chartered Accountants in England and Wales may not be in the best position to act as appointing authority in case of disagreement of the parties as to the nomination of the expert. As a result, we suggest considering the London Court of International Arbitration – LCIA or the Academy of Experts as the appointing authority if the expert determination relates to technical issues other than accounting matters.

Finally, we believe that it is necessary to empower the executive body of the ProjectCo to take all urgent measures which are necessary or useful to secure the rights of the HoldCo (or the ProjectCo, as the case may be) or to avoid that these companies be in breach of their obligations under the Project Agreements, in the course of the dispute.

Loan Stock Instrument

Question 16: ***Do you agree that shareholder loan stock should be unsecured?***

We have no objections in this regard, as loan stock has to be equivalent to equity.

Question 17: ***The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism?***

We believe that the Bidder's costs and risks relating to the bid shall be compensated by a success fee, payable by the ProjectCo to the Bidder upon the financial closing and a management fees during the operation phase..
We understand it is not advisable to have different rates of return on loan stock. After the financial closing, all shareholders must be in line as to the risks and opportunities relating to the Project and have equal investment instruments.

Other issues

Question 18: ***Please comment on any other matter which you regard as important in connection*** **with equity investment in PF2 projects by the public sector.**

A new approach to public private partnerships:

consultation on the terms of public sector equity participation in PF2 projects

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A response to HM Treasury from:

Wates Group

August 2013

In July 2013 HM Treasury issued their paper "A new approach to public private partnerships: consultation on the terms of public sector equity participation in PF2 projects". In accordance with the terms of that document, and in response to the invitation to respond contained within it, Wates Group are pleased to respond to the consultation paper. We welcome the opportunity to comment on HM Treasury's proposals and hope that our comments will be of use in the development of this vital market to UK infrastructure investment.

Wates Group has a long history of involvement in PFI and PPP in the UK. This includes both education and housing projects, totalling over £400m. Wates' involvement in private finance projects has principally been as a constructor, undertaking the role of construction sub-contractor and/or housing maintenance. Wates also has a considerable track record as equity and sub-debt investor on almost all of its 14 private finance projects, both as majority and minority investor, and we have a policy of recycling equity investment which has given us experience in the secondary equity market. We are therefore characteristic of the "developer equity" class of investors discussed in the Treasury consultation paper, and our comments below are borne of the experience of developing, funding, and operating PFI projects as contractors and equity funders.

Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements? Naturally HMT would wish to conduct appropriate due diligence over the investment that it wishes to make, however it is not clear why this process would be carried out prior to preferred bidder if the preferred bidder evaluation is not linked with this process and the Treasury investment will not affect the choice of preferred bidder. Therefore, why would HMT wish to carry out due diligence three times over for the same project? We envisage this process as being similar to the provision of an information memorandum and document package for a secondary market equity sale. The format of the Due Diligence Memorandum itself is unclear – we do not see how the legal advisors for the developer could provide such a memorandum without giving rise to a conflict of interest, and would expect to see HMT engaging its own advisors to carry out due diligence. Doing this with a single preferred bidder would reduce costs. We also have some degree of reservation about whether advisors to the developer equity would be prepared to give letters of reliance to HMT, again for the reason of potential conflict of interest.

Question 2: Do you think the informal public sector equity guidance arrangements during procurement will be of benefit to bidders? Our view is that any additional guidance would be welcome, and we look forward to the expertise that we hope HMT will provide in this process, with good practice and sharing of knowledge being accumulated as projects come on line. The more that guidance can be relied upon, the more bidders will be able to minimise bid cost, resource and time on pursuing unworthwhile paths.

Question 3: Do you have any objections to disclosure of the Transparency Information? None. We believe that these provisions are a natural progression along the road of improved accountability for public/private projects and a logical next step towards improving freedom of information. We do think that HMT should distinguish between information required as a shareholder, and information required as a guardian of public finances. Thus, HMT continuing to require shareholder information after it has ceased being a shareholder is in our view excessive.

Question 4: What are your views on the following arrangements to promote new equity investors?

a. **Equity funding competition post appointment of preferred bidder?** This is certainly feasible and could provide a useful means of bringing in new investment. However, HMT's requirements for the allocation of equity to public, developer, and competed equity must be known at the outset of procurement so that the developer can assess the potential risk and reward equation it is prepared to take with its equity. Otherwise the developer's upside potential will be limited and the sort of margins that the developer will be looking for to offset bidding risk will lead to an imbalance in returns on different classes of equity. Alternatively, uncertainty over the potential returns could lead to developers pulling out of the equity funding element, which would have an adverse effect on the market. Potentially a competition could be held for a defined element of equity with the intention of driving down the cost of equity funding, but would have to be carried out on the basis of absolute acceptance of the terms of equity documentation in order to ensure true competition.
b. **Reduction in HMTCo equity post financial close (either during the Lock in Period or thereafter)?** Assuming the intention is to attract institutional investors at the earliest stage, we do not see that this will significantly attract such investors. Prior to the completion of the lock-in period, the tail-end of construction risk will still be present, which is in our view more likely to put off institutional investors who are averse to construction risk. Under this scenario, we would suggest that the market would be very cautious and transaction costs are likely to swallow up a major part of any gain. Post lock-in, we anticipate that any equity holder could be looking to sell (particularly developers) and thus the minority stake held by HMT is unlikely to have a substantive effect on the market unless either sold as a portfolio or sold in conjunction with another shareholder. It is also worth noting that a position which sees HMT seeking to dispose of its share at the earliest opportunity (particularly if the other shareholders cannot do so – we do think that the provision which allows HMT disposal prior to the end of the lock-in period is not commercial) does not give potential investors a great deal of confidence in the projects. HMT should in dealing with its equity holdings be as commercial as possible, which will maximise investor confidence.

Question 5: Where there is a reasonable expectation that ProjectCo will require working capital (or Senior Funders otherwise require a firm commitment for working capital), do you agree that this should be provided by the Developer? We see no reason why not, mirroring current practice. We do not see this being provided by equity.

Question 6: Do you agree that shares and loan stock should be stapled so that they cannot be sold separately (except with the consent of all other shareholders)? Generally we agree as this maximises the value of the sale and the secondary market. On rare occasions this might be appropriate for public sector bodies to have shares without associated loan stock but if so the loan stock should be allocated pro rata among the other shareholders and stapled on that basis.

Question 7: What are your views on the pre-emption provisions? These looked to us to be in the form which we would typically expect to see.

Question 8: Do you agree with the event of default and deemed transfer provisions? The protections against Unsuitable Third Parties previously referred back to the PA, or required Authority approval against incoming shareholders, were logical and understandable as long as they did not amount to a means of preventing fair trade in secondary equity. We note however the extension of this to where an existing shareholder becomes an Unsuitable Third Party as an event of default. We think this will be very difficult to work and potentially can provide a windfall gain (sale of shares at par) for the remaining shareholders.

Question 9: Do you have any comments on the definition of 'Market Value' and the manner in which this will be determined? This looks to be in a form which is fairly typical where the value of the company was determined by reference to income rather than assets and although there is a potential for conflict in having the company's auditors act as valuers, the auditors could decline the instruction.

Question 10: What are your views on the proposed arrangements for nomination and composition of the board of directors? We think these are what we would normally expect to see, however we note that this implies a minimum 15% HMT holding if HMT are to have director representation. We understand that for education projects the relevant Local Authorities will be represented by observers to the board, we welcome this as it has worked well on our LEP projects and on earlier projects where the Authority has taken a minority equity stake.

Question 11: Do you agree with the provisions relating to the chairman? We have no problem with these.

Question 12: Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements (a) when HMTCo is a shareholder and (b) thereafter? As discussed above, we welcome the involvement of observers representing the Local Authorities. We also believe that HMT's involvement as shareholder will add to the strength of the board. However, we do not see the rationale behind HMT retaining an observer after they had divested themselves of their interests in the relevant company. This requirement potentially runs contrary to the principles of good governance of a company as the directors were less likely to have full and frank discussions in front of a third party and may resort to conducting business by way of written resolution to side step the requirement. It would be highly unusual for a company in any other sphere to allow this and it was noted that incoming shareholders, who, once the assets were built and operating, were likely to be investors may have issues with this concept. We believe that if HMT want to retain a role in the governance of the SPVs, they should retain a shareholding.

Question 13: Please give your views on the proposed provisions identifying any changes you consider appropriate to the Reserved Matters and Reserved Matters Board Approval, in each case giving your reasons and explanation for your views? The following were picked out as potential areas of concern:

c. **B2** – this potentially gives HMTCo a veto in situations where additional cash needs to be injected by way of an equity cure to prevent insolvency, default and/or failure of the project for some reason (e.g. to fund a cost overrun).

d. **B9 and B10** – were likely to be overridden by the provisions of the senior funding arrangements as any change in control would likely require lender consent.
e. **B11** – it was noted that the purpose of this was not clear as there is no definition, or accepted meaning, of the phrase "shareholder's undertaking".
f. **C5 and C6** – it was noted that these were, in all likelihood, going to be influenced/affected by the senior funding arrangements.
g. **C7** – the reasons for the inclusion of this were understood but it was likely that any sponsor would probably already have sufficiently robust policies in place. It was also noted that this was repeated at F1.
h. **D2** – noted that most projects have an MSA as the project company is an SPV with no expertise or ability to perform these tasks itself.

We would also suggest that there needs to be a mechanism whereby incapacity of one shareholder does not of itself prevent resolution of reserved matters – if for example one of the shareholders cannot vote there needs to be a mechanism to resolve reserved matters even if less than 100% of the shareholders can vote. Perhaps a position where in the event of a reserved matter being unresolved, a positive vote of all those able to vote.

Question 14: Do you think the proposed arrangements regarding a Director's conflict of interest (SHA clause 6.3) are practicable? We think these are reasonable and what we would generally expect to see.

Question 15: Please give your views on the proposed dispute resolution arrangements (SHA Clause 11)? These look pretty usual insofar as they relate to dispute resolution but we would suggest that there is a need for a working deadlock procedure which is binding – at present the drafting permits the expert decision to remain unbinding, which leaves only the judicial system as a means of resolving the deadlock.

Question 16: Do you agree that shareholder loan stock should be unsecured? Yes – securing the loan stock would change the character of the projects.

Question 17: The Bidder incurs costs and risk in bidding for a PF2 project which are not borne by equity investors who make their financial commitments at financial close. Please give your views as to whether this should be reflected in differential rates of return. If you support a differential rate of return, how should this be structured? In particular, do you think a higher interest rate on loan stock is an appropriate mechanism? Direct payback of bid costs are achieved at FC and repaid over time through the unitary charge. This does not cover however the bidding risk taken by each bidder and the risks taken during the procurement process. In the past, return on these was in part fulfilled through the equity upside. Restricting developer equity (in either volume and/or return) will restrict the ability of the developer to claw back the risk pricing represented by unsuccessful bids and bid cost overruns, and require such pricing to appear up front in the financial model, thereby increasing its cost and reducing VfM. Equity partners involved in the bidding process also take these risks and bidding costs in return for upside on equity. To offer equity to potential investors who are not taking bid period risk and cost at the same rate as developer equity is not realistic, therefore some form of differential pricing seems inevitable (unless the latecomers have a small minority share). We would favour a competition whereby potential equity investors bid to the developer capital sums to “buy” an equity share to compensate the developer for the risk taken during procurement. Whatever the mechanism used, recognition should be made that the developer is the one taking the risk during the bid phase and that this should be reflected in the opportunity for returns, while reducing overall funding cost.

Question 18: Please comment on any other matter you regard as important in connection with equity investment in PF2 projects by the public sector. The key issues are as set out in our response to question 17 above. We would also add that there needs to be some mechanism whereby the potential returns to the developer equity remain the same irrespective of whether HMT takes up their equity share or not – or alternatively some form of compensation/enhanced return to the developer occurs if HMT subscribe for equity, thereby reducing the developer's equity share and return.

We hope that this has been useful and would welcome the chance to discuss any of the above with HMT if required.