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PF2 – Consultation on the term of public sector equity participation in PF2 projects

We set out below Allen & Overy LLP's response, dated 21 August 2013, to the HM Treasury and Infrastructure UK open consultation on *A new approach to public private partnerships: consultation on the terms of public sector equity participation in PF2 projects* dated 10 July 2013.

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<tr><th>Consultation question</th><th>Comment</th><th>Response to Consultation</th></tr>
<tr><td>Question 1: Please give your observations on the proposed investment appraisal and due diligence arrangements?</td><td>We comment on paragraphs 4.5 and 4.6 of Section (Investment Appraisal Process) to the effect that Treasury PF2 Equity Unit will require:
(a) a Due Diligence Memorandum; and
(b) letters of reliance from advisers to the project company.</td><td>Legal advisers to the project company have not, historically, prepared a due diligence report on a project, but rather the understanding of the project has developed through multiple bidding phases. This will therefore increase the burden on advisers to the project company to explain the position that the sponsors and lenders have reached (and the reasons for it).

A key question would be the timing of preparation of the report – it would not be efficient for each bidder to prepare one, but, at the same time, leaving it to preferred bidder could raise the question of what happens if the public sector investors or new investors are not happy with particular parts of the report.

This new approach would mean that initially, a scope of work would have to be agreed with a wide range of interested parties, which will involve additional time and expense at an early stage of the process.

We understand the intention would be that the report be prepared on the instructions of, and addressed to, the project company, issued prior to exchange of the Project Documents. In other markets, legal advisers will normally consent to equity and debt providers (as third parties to their engagement) to place reliance on that report, but on the following (non-exhaustive) terms:
(a) reliance would be on terms that instructions on the parameters of the report have been given by project company and may not address the concerns of debt and equity providers;
(b) to the extent that the project company had agreed to limit the adviser's liability in any way (eg to a fixed amount), such limitations would also apply to reliance by third parties;
(c) terms of reliance by third parties would include restrictions on the ability for those third parties to further disseminate the report, both to respect confidentiality terms (as may be agreed with the project company) and to avoid the creation of a duty of care to other parties; and
(d) reliance would otherwise be subject to the terms as agreed between the project company and the adviser, including as to the date on which the report is made up to (which will be at a date earlier than financial close).

The terms the public sector sponsors are looking for from the various advisers would need to be agreed in advance to avoid repeated negotiation on a deal by deal basis.</td></tr>
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Consultation question	Comment		Response to Consultation
Question 3: Do you have any objections to disclosure of the Transparency Information? Please give reasons for any objections.	Clause 8.4(a)(ii) of the July 2013 Consultation Draft of the PF" – HoldCo/SPV Shareholders' Agreement (the **SHA**) obliges each Shareholder (as defined) to provide to the other and to Treasury PF2 Equity Unit (if not then a Shareholder) the Transparency Information, being:		We draw HM Treasury's attention to the discussion paper Transparency & Trust: Enhancing the Transparency of UK Company Ownership and increasing Trust in UK Business published in July 2013 by Department for Business Innovation & Skills (the **Transparency & Trust Consultation**), which proposes, amongst other things, a public register beneficial ownership of English companies. The Transparency & Trust Consultation highlights the challenges of imposing obligations on a company to disclose details of its ultimate controllers, both because the information may not available to the company other than through hearsay and because, currently, no effective procedure exists to enable a company to procure disclosure to it of such information. We would invite HM Treasury to await the outcome of the process initiated by the Transparency & Trust Consultation to determine an appropriate contractual obligation to be included in the SHA. Separately, we consider it inappropriate for Treasury PF2 Equity Unit to continue to enjoy the benefits of such disclosure obligations after it ceases to be a shareholder in the project company and should, instead, rely on the statutory amendments to be introduced following the outcome of the process initiated by the Transparency & Trust Consultation. If HM Treasury is nevertheless of the view that Treasury PF2 Equity Unit should continue to enjoy the benefits of such disclosure obligations, they should be contained in the Project Agreement with the project company and not in the SHA. See our answer to Question 18 below.
	(a)	the identity of each person having a beneficial interest in Shares or Shareholder Debt (as defined), their jurisdiction of incorporation and tax residence. If an individual, his nationality and tax domicile; and	The draft SHA includes a drafting note here to the effect that a carve-out can be included here for "publically[1] quoted companies and funds". We therefore assume that the disclosure obligations do not afford the term "beneficial interest" its ordinary meaning (so as to distinguish the ownership of the legal and beneficial title to the relevant instruments in the project company), but is intended to refer to, effectively, the ultimate legal owner of the instruments (and so of the Shareholder). This should be clarified and guidance given as to how the Shareholder is to comply with this obligation (which should be limited accordingly). As noted above, this information will not be available to a Shareholder and, in addition its disclosure, particularly where it relates to new beneficial holders of the relevant instruments, may itself be subject to confidentiality obligations (whether at law, including the laws of another jurisdiction, or by contract(s) entered into outside of the Shareholder's knowledge or control), having regard to the ability to Treasury PF2 Equity Unit to publicly disclose such information (also as set out in clause 8.4(b)(ii) of the SHA).
	(b)	the terms on which that Shareholder wishes to dispose of any Shares or Shareholder Debt (including the name of the transferee and the price to be paid).	In addition to the comments outlined above, we note that HM Treasury has, in clause 9.1(a) of the SHA and in the draft articles of association made available for consultation (the **Articles**), determined to adopt a "right of first refusal" process for pre-emption such that Shareholders are to be invited to purchase the Shares and Shareholder Debt of a selling shareholder at a specified price. If such Shares and Shareholder Debt are not taken up by the other Shareholders, the selling Shareholder may dispose of its interests, provided that the sale is not at a lower price (or otherwise on better terms) to that offered to the other Shareholders and provided that such sale is not to an Unsuitable Third Party (as defined). This procedure contrasts with the 'right of last refusal' formulation which would see a Shareholder offer its interests for pre-emptive transfer once it had found a third party purchaser and agreed terms. Given HM Treasury's desire to pursue a "right of first refusal" and the protections noted above, seeking to also receive the information

[1] Although the spelling "publicly" is more commonly used – see Companies Act 2006.

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Consultation question	Comment	Response to Consultation
		set out in paragraph B3 of Schedule 7 to the SHA is, in our view, putting HM Treasury in a privileged position, is outside market practice and not reasonable.
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)?	We note that, as drafted, the SHA envisages the subscription by the proposed Shareholders for Shares and Shareholder Debt in the amounts to be set out in the Data Sheet. See also our response to Question 17.	The Data Sheet has not been provided, but on the assumption that such Data Sheet will provide for pari passu subscriptions by each of the proposed Shareholders (and we make this assumption as no separate share or loan note classes have been assumed in the drafts), HM Treasury should, in its response statement to this consultation, set out its understanding of the intended economic returns for the Developer (in addition to the treatment of costs as envisaged by question 17); ie given the third party equity and Treasury PF2 Equity Unit's ability to each participate (at its option) in the investment in its final stages, how is the Developer to receive upside for its 'opportunity costs' in having led the tender through all earlier stages and taken the risk of losing (with all the consequent wasted costs)? We note the proposal, at question 18, of "rewarding" the developer by reference to a higher interest rate on the Shareholder Debt, but would expect developer to also enjoy a higher proportion of return on equity and question how this higher interest rate would be quantified to compensate the Developer for its risk. The approach does raise other questions of who will be invited to bid (e.g. will the existing investors, including the Developer and any financial partners be able to compete?).
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 standard practice in principle, however, we would recommend that the common practice also be catered for, namely that the draft documents allow for the instruments to be held by different members of the same 'group' as is to be defined in the SHA and Articles.
Question 7: What are your views on the pre-emption provisions?	We refer to the pre-emption procedure set out in article 13 of the Articles.	We have no substantive comments in addition to the relevant comments set out in the answer to Question 3 above. However, we do have some comments on certain of the restrictions on transfer set out in clause 9 of the SHA and article 12 of the Articles: (a) clause 9.1(e)(ii) of the SHA forbids the Shareholders from "enter[ing] into any agreement in respect of the votes attached to any Shares (other than in any shareholders agreement entered into between the shareholders of any company which is a Material Shareholder)". Having regard to the drafting in italics (our emphasis added), such voting agreements are not voting agreements in respect of the Shares but control arrangements over the Shareholders - not therefore prohibited by the general restriction. Consequently, we recommend the deletion of the italicised section to avoid uncertainty as to the intended application of the restriction; (b) by reference to clause 9.1(h) and the definition of Unsuitable Third Party: (i) potential investors will be primarily concerned with certainty of interpretation of the definition, given the draconian consequences of effecting a transfer to an Unsuitable Third Party in error. Consequently, (A) the definition of Suitable Third Party should expressly refer to the determination of suitability at the time of the relevant transfer; and (B) limb (c) of the definition of Unsuitable Third Party provides for the determination to be "in the reasonable opinion of HMTCo" – can HM Treasury provide guidance on how potential transferees will be able to obtain comfort on this at the time of the transfer. In addition, the consequences of breach should be amended to impose consequences on the transferee who is found to be an Unsuitable Third Party and not on the transferor; and (ii) we do not comment on the policy grounds for the inclusion of limbs (a), (b) and (d) of the definition of Unsuitable

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		Third Party. However, having regard to the second assumption adopted in our answer to Question 18 below (being that that HMTCo be treated as if it were a commercial equity investor acting to maximise its economic interests only), we are of the view that such restrictions should be reflected in the Project Documents (as they always have been since SOPC started) and not the SHA; and (c) by reference to article 12.1 (as to transfers to affiliates), we note that HMTCo may freely transfer its Shares and Shareholder Debt to any member of the HMT Co Group (and, as drafted, any transferee may then freely assign on its interest within that group). We are of the view that the definition of HMT Co Group is unreasonably wide (particularly as to limb (c) of that definition) and that, given that HMTCo transfers are not subject to clause 12.1(c) (requiring Shares and Shareholder Debt to be transferred back to a Shareholder in the event that the affiliate relationship is terminated), such provisions extend beyond normal market practice to effectively render HMTCo's shares freely transferable, outside of the pre-emption process.
Question 8: Do you agree with the event of default and deemed transfer provisions?	Definition of Transfer Event in the Articles and of Event of Default in the SHA	We note: (a) a degree of duplication between the two definitions, particularly as to "insolvency" events, which should be addressed in the drafting; (b) the cross-reference between clause 9.2 of the SHA and article 14.1(d) of the Articles, which should be amended since the occurrence of an Event of Default under the SHA does not give rise to a requirement to give a Transfer Notice, the breach of which requirement invokes a Transfer Event under article 14.1(d) of the Articles; (c) limb (e)(i) of the definition of Event of Default as to the sale of all or substantially all of the business of a Shareholder to an Unsuitable Third Party. Given the restriction on a sale of Shares or Shareholder Debt to such a person is already prohibited, we would argue that such an event (in circumstances where the Shares or Shareholder Debt were retained by the Shareholder) ought not to be included as it does not create a relationship between the project company and the Unsuitable Third Party; (d) by reference to limb (e)(ii) of the definition of Event of Default, we would similarly query the inclusion of this event in circumstances in which the Shares or Shareholder Debt are not also transferred (which purported transfer would be subject to the protections afforded by the pre-emption procedure); (e) by reference to limb (g) of the definition of Event of Default, we would query the reference to "attempting to sell [...] any of the assets of the Company" as outside of the control of any Shareholder; and (f) the consequence of an Event of Default where (i) other Shareholders have not taken up the relevant Shares or Shareholder Debt on the issue of a Deemed Transfer Notice and (ii) the Sales Agent process set out in Schedule 5 to the SHA has been exhausted without any sale, is a disposal to other electing Sharehodlers of the relevant instruments at par (as set out in clause 9.5). Such a mandatory transfer at consideration which is (likely to be) less than market value is draconian having regard to the range of Events of Default including 'no fault' events (eg insolvency, which may also offend anti-deprivation principles). This should be reconsidered. As to the ability for HMTCo to make an election to purchase such instruments at par pursuant to clause 9.5 of the SHA (as envisaged by paragraph 8(b) of Schedule 5, please see our comments below in answer to Question 18.
	Application of the deemed transfer provisions in article 14.2	We note that the draft Articles propose to apply the Deemed Transfer Notice (as defined therein) to "the Shareholder in [default] on and any other Shareholder who has acquired shares from him under a permitted transfer in accordance with article 12 (directly or by

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	of the Articles	means of a series of two or more permitted transfers) [...] in respect of all the shares then held by them." We suggest that the application of the Deemed Transfer Notice to all transferees of a Shareholder in default (including whether intra-group pursuant article 12.1; to third parties subject to pre-emption pursuant to article 12.4 or with the consent of all other Shareholders in accordance with article 12.4) is unreasonable and will have material detrimental effects on the value of the Shares and Shareholder Debt. We separately note that this would also affect any transferee of Treasury PF2 Equity Unit.
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 comment here on clauses 5 and 6 of the SHA.	By reference to clause 5.1(b) of the SHA that HM Treasury proposes to cap to three the number of appointees to the board of the project company for each Material Shareholder. This is, in our view, unusual (as a holder of 60 per cent. or more of the Shares should have the right to appoint a majority of the board). Minority Shareholders would be expected to be satisfied with the degree of control afforded by the list of reserved matters set out in Schedule 8 to the SHA, which require the positive approval of each Material Shareholder (whether as shareholder or through its appointee(s) to the project company board) in accordance with clause 6.2 of the SHA. By reference to clause 5.3(b) of the SHA, as to the removal of directors appointed by a Material Shareholder, we note the reference to: "If any Material Shareholder (an **Outgoing Shareholder**) ceases to be a Material Shareholder and any Director is an employee and/or officer of the Outgoing Shareholder or has been nominated as a Director by the Outgoing Shareholder pursuant to clause 5.1 (Composition of the Boards and the right to appoint Directors), the Outgoing Shareholder shall procure that any such Director vacates office [...]". We would recommend the deletion of the words underlined to cater for circumstances in which the project company retains directors connected to a Shareholder (eg in an executive function). but which have not been appointed by that Outgoing Shareholder; and, which the project company would wish to retain regardless of the connected Shareholder being an Outgoing Shareholder.

Consultation question	Comment	Response to Consultation
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?	Please see our comments in answer to Question 18 (Other Issues) below. In reply to Question 13, we offer no comment on the list of Reserved Matters save to note that this should be matter for negotiation on a project specific basis.	
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.		
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.		
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?	Please see our answer to question 4 (General Considerations) above which queries the returns available to the developer. As to the treatment of costs incurred prior to equity participation, we would expect that such costs are fully reimbursed by the project company to the developer at the time of equity subscription and reflected in the Data Sheet (and not deferred as forming part of the Shareholder Debt, as is proposed).	

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Consultation question	Comment	Response to Consultation
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.	We would highlight the following considerations for HM Treasury having regard to the following assumptions adopted in formulating our response, being that HMTCo (as defined) be treated as: (a) if it were a commercial equity investor acting to maximise its economic interests; and (b) a connected person of the relevant Authority which is the party to the Project Agreement(s). This assumption is supported by the carve-out to the restriction on Share voting arrangements for HMTCo set out in clause 9.1(e), which is itself contrary to assumption (a) above.	
	Conflicts of Interest	Having regard to assumption (b) above, it is not appropriate for HMTCo to participate in discussion (or otherwise to have access to information) in circumstances in which its connection to the Authority gives rise to a conflict of interest and, consequently, we consider that: (a) any director appointed by it in its capacity as a Material Shareholder should be excluded from any such matter discussed at board meetings of the project company; (b) equivalent provisions to those envisaged in respect of claims by or against the Developer, as set out in clause 6.5 of the SHA, should be included in respect of such matters; and (c) other Shareholders should have the ability to exclude the Observer (as defined) without the approval of HMTCo. In addition, we note that the ability to exclude the Observer by majority vote (as set out in clause 5.6(e) of the SHA) is overridden by the requirement for HMTCo approval during the Lock In Period as a result of the application of clause 5.5(A)(i)(A) which would be contrary to this principle.
	Survival of SHA rights	Market practice is for shareholders' agreements such as the SHA to contain contractual rights afforded to shareholders of a company in their capacity as such. It is not normal practice for rights (or obligations) of such persons to survive their disposal of shares. Consequently, we are of the view that the survival of rights afforded to HMTCo in the SHA is not appropriate and is contrary to assumption (a) above. Consequently, if HM Treasury is minded to retain such rights, we would recommend that they be included in the Project Agreements.
	Guarantee of Project Agreements	Having regards to assumption (b) above, we note the undertaking in clause 6.4 (being an undertaking by each Shareholder to procure compliance by the SPV (as defined) of the Project Documents) of the SHA would fall to be practically treated as performance guarantee given to the Authority of SPV's obligations under the Project Documents and should be dealt with in the Project Documents and not the SHA. In addition, we would expect this this obligation to be expressed as an obligation by each Shareholder to the other(s), and not for the benefit of the Company or the SPV (as defined), to not take any action which would cause the Company or the SPV to breach the Project Agreements (or relevant finance documents). Separately, we note the obligation on the "preparation of any report required by a government department from time to time" set out in clause 8.4(a)(iii) of the SHA, which obligation is expressed to bind Shareholders and which, in our view (as well as the corresponding obligation in clause 8.4((b)(iii)), should be limited to the Company and the SPV and reflected in the Project Documents. A similar consideration arises in respect of the obligation set out in clause 8.3(a), as to Shareholders procuring that the Company and the SPV maintain appropriate records, which obligation should be qualified to be limited to matters within the Shareholders' control.

For any questions or comments on this response, please contact:

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21 August 2013

BY EMAIL

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SW1A 2HQ

Dear Sirs

Public private partnerships: consultation on the terms of public sector equity participation in PF2

We are an international law firm which undertakes work for government, government agencies and non-departmental government bodies as a result of (and frequently in connection with) a procurement process and which advises clients who do similarly.

The purpose of this submission is to outline a number of tax structuring considerations which either need to be addressed or considered in drafting these terms to increase the attractiveness of the PF2 structure to private sector organisations.

The comments below are limited to tax comments and accordingly we have only responded to relevant questions.

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

The loan stock may be recharacterised as a distribution as a result of the provisions in Chapter 2 of Part 23 of the Corporation Tax Act 2010 if it advantageous or necessary to dispose of loan notes together with shares. The effect of this would be that no corporation tax deduction would be obtained by SPV for interest accruing under the loan notes. Provided that the loan notes are issued by the SPV rather than HoldCo as envisaged in the consultation, then these distribution rules should not apply. However this would become a concern if HoldCo was the loan note issuer.

In addition, the drafting would need to ensure that the loan notes do not confer upon the holder a right to acquire shares to prevent the following provisions applying:

(a) the loan note holder being treated as an equity holder in the company issuing the loan notes by virtue of the equity holder provisions in chapter 6 of part 5 of the corporation tax act 2010 with the effect that the company issuing the loan notes may be degrouped from its parent company for group relief purposes. This would prevent surrenders of tax losses between those companies; and

(b) the loan notes ceasing to be exempt loan capital for stamp duty purposes. This would mean that the transfer of the loan notes would be subject to stamp duty at the rate of 0.5 per cent.

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Question 10: What are your views on the proposed arrangements for nomination and composition of the board of directors?

It is noted that clause 8.5(a)(i) provides that each shareholder must use its reasonable endeavours to ensure that both HoldCo and SPV are treated by relevant authorities as being resident for taxation and other purposes in the United Kingdom. This would require that board meetings are held in the United Kingdom and have implications for the composition of the board of directors. A standard provision to this effect may be in breach of EU treaty fundamental freedoms (for example the freedom of movement of capital or the freedom of establishment).

Other matters relevant to the consultation

We would like to draw your attention to the following issues which we would suggest should be considered further in relation to the structuring of the various agreements:

(a) Clause 8.5(a)(ii) of the shareholder's agreement provides that no shareholder shall receive any gross up that arises as a result of it being or becoming resident for tax purposes outside the UK. This is a commercial matter. However , the indemnity given by each shareholder in clause 8.5(a)(iii) to the other shareholders for losses incurred by the other shareholders as a result of the relevant shareholder ceasing to be resident for tax purposes in the UK may cause concern for some international investors.

(b) We agree that the shareholders agreement should include provisions relating to consortium relief (see clause 8.5(b)), but would recommend that more specific provisions are included. Generally if consortium relief is an important aspect of the financial modelling, a shareholder would require the ability to procure that the consortium company makes the surrender in consideration for the agreed quantum of payment. It would be useful to include a standard form provision to this effect at least as an alternative to the 'agreement to agree' currently included in the contract. It may also be necessary for the public sector investment to be held by a body corporate to allow other shareholders to claim consortium relief.

(c) There will be a number of other tax considerations particular to each individual PF2 arrangement. We would not propose including standard form provisions on these matters but would suggest the inclusion of a footnote acknowledging that bespoke provisions may be required in respect of the following issues:

(i) Transfer pricing. The parties may wish to include provisions requiring that all transactions between shareholders and the company and the SPV are carried out on arm's length terms and to provide for appropriate compensating adjustments and payments between the parties to be made to the extent that there are transfer pricing adjustments;

(ii) VAT Grouping. The parties may wish to include provisions preventing HoldCo and SPV from forming a VAT group with entities other than wholly owned subsidiaries as in these circumstances the companies could become jointly and separately liable for third party VAT liabilities;

(iii) World wide debt cap. A provision may be included regarding allocation of disallowances under the world wide debt cap provisions preventing an individual shareholder manipulating those allocations to the detriment of other shareholders.

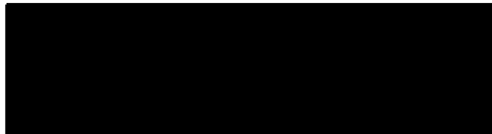
(iv) Group payment arrangements. If appropriate, additional provisions could be required ensuring that payments of tax pursuant to a group payment arrangement are properly made and allocated to the appropriate companies.

Public Procurement Provisions

We note also that the definition of event of default in the shareholder's agreement includes a shareholder disposing of all or a substantial part of its business or assets to an unsuitable third party; or the changing of the nature or scope of its business such that it becomes an unsuitable third party. This consultation draft was published before the Cabinet Office issued Action Note 06/13 Procurement Policy Note: Measures to promote tax compliance on 25 July 2013. These provisions will need to be amended in the light of this document. We have specifically commented in relation to the procurement policy consultation and do not propose to comment further on this in relation to PF2 except to note that currently the definition of unsuitable third party is drafted from a UK perspective and does not encompass similar provisions in other jurisdictions. This acts to the detriment of UK bidders and the language should be broadened such that it applies to parties in other jurisdictions, by, for example, removing the reference to HMRC in the definition of unsuitable third parties.

If you have any questions in relation to this submission, please contact Nicholas Gardner of this office using the details set out above.

Yours faithfully



Ashurst LLP

Consultation response for Astrium Services

Paradigm Secure Communications (contracting entity for Astrium Services Government Communications) currently holds the Skynet 5 PFI contract (FSAT/C1/1000) for the delivery of satellite communications to UK MoD which runs until 2022. Our interest in PF2 is in the context of the future Beyond Line of Site communications (BLOS) and which contracting mechanisms that may be used for follow on contracts post 2022.

We have reviewed the Consultation draft (July 2013) and have the following observations in response to the consultation questions:

- The structure may constrain the Developer in terms of development of Project Co in cases where there are 3rd Party market opportunities including export sales. The presence of a UK Government representative on the board may lead the Developer to pursue such opportunities outside the Project Co (albeit paying a fee to Project Co for use of assets where appropriate). This may be due to the transparency and disclosure requirements or the concern of 3rd party customers, particularly for defence applications or services. This would add complexity and also may lead to a sub-optimal and less robust Project Co

(Relates to Qs 18)

- The Developer has to offer a fully funded Project, including Equity, with the prospect of HMT or 3rd Party equity providers participating at a later stage. It seems that the Developer has to 'make the hard yards' in being comfortable with 100% of the Equity and develop the Project with all the bidding risks and uncertainty whilst the other potential Equity providers can determine their participation when everything is in place and Due Diligence reports are made available to them. This seems in-equitable and supports a return premium for the Developer

(Relates to Qs 4 and 17)

- The addition of an observer seems un-necessary and the role, accountability and reporting is unclear. Transparency is served by the HMT board member which is one of the primary aims of the PF2 arrangements. If there is no HMT board member then any reporting or transparency should be a contractual matter.

(Q 12)

- There is a degree of additional Due Diligence required or at least reporting that is required which will have a cost impact that will have to be recognised in the Project.

Balfour Beatty

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

Balfour Beatty is a world-class infrastructure services business, operating in four key areas:

- Infrastructure investments
- Professional services
- Construction
- Support services

The Balfour Beatty group employs over 50,000 people with operations in over 80 countries and has a combined turnover of over £10bn.

This response is submitted in the group's capacity as a developer and primary investor in public private partnerships. The group is typically also a participant in the design, construction, operations and lifecycle aspects of these projects.

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

Key points to note include:

- Efficiency of due diligence prior to appointment of preferred bidder will be improved if it is limited to a review of the information requested as part of the bid. If detailed discussions were to be held at this stage this could extend the procurement timetable
- Avoiding the need to provide due diligence information from external advisers at the bid stage is welcomed as it will help to limit incremental costs of the appraisal process
- Conversely the use of legal advisers to produce the Due Diligence Memorandum (which we assume will be done at the preferred bidder stage) is likely to lead to an increase in bid costs. Broadening the duty of care obligation of other project company advisers may also result in increased costs

It would be helpful to have further detail on the intended process and the level of due diligence information required (e.g. in relation to the PF2 Equity Bid Information) in order to assess the impact of the proposed arrangements.

The required due diligence will carry an incremental cost, whether through additional scope or simply the inclusion of an additional party to whom a duty of care is owed. Under the Building Schools for the Future programme, the public sector (as investor) requested a more limited range of external advice (principally the model audit); if a similar approach was adopted here this would reduce procurement costs.

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.

Yes, on the understanding that it would be on a confidential basis, ring-fenced from the discussions with other bidders.

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

We understand and support the need for greater transparency but note that there should be a balance between this and the needs of the private sector to keep commercially sensitive information confidential. For example, releasing certain information (e.g. equity returns) shortly after a project has reached financial close could disadvantage a bidder that is involved in an ongoing PF2 procurement programme in the same sector. As such, we would propose that disclosure of commercially sensitive information should not be made on the basis of individual projects at least until a reasonable period of time has elapsed after financial close, for example until the end of the construction period.

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 prefer not to have an equity funding competition as this process will reduce the level of equity investment (and return) for the same level of bid cost risk making primary bidding less attractive.

It would be helpful to have more detailed information about how it is intended that these competitions would work.

Should equity funding competitions be used, we have a number of suggestions/observations:

- Developers should have the option to retain a minimum level of equity so as to ensure there is a commercially sensible balance between the bid cost risk and the investment opportunity. We would suggest a minimum level of around £10m (as well as the bidder holding the majority interest). Developers could also be given the right to match in the competition
- For smaller projects, having three shareholders from financial close could make the economic interests too small for the private sector parties
- Both of the previous points could be addressed by (i) ensuring that where possible projects involve bundling of opportunities and (ii) by limiting the use of HMTCo and/or third party equity for projects below a certain size
- We assume that third party equity providers coming in through the competitive process will earn a lower rate of return due to the absence of bid cost risk. This could be structured through a premium being paid for the same yield as the developer, with part of the premium going to the developer to compensate for the loss of investment opportunity
- It will be essential to ensure that developers have control over the competition and the selection of their partners and that commercially sensitive information is not disclosed to competitors. It is currently unclear whether developers will have this level of control/discretion.
- The bid evaluation process for the competition should cover qualitative aspects (such as capability) as well as pricing. Investors who are new to public private partnerships (and who may have no track record) will need to demonstrate that they have the capability and resource to contribute to the smooth and effective running of projects
- There is a risk that equity funding competitions might simply encourage existing financial investors to switch from primary bidding to funding competitions at preferred bidder as these will involve less time and cost
- Fundamentally, one of the best ways to attract new investors will be to have a clear and substantial pipeline of future projects

A third party equity provider would need to accept the project on the terms established by the preferred bidder. This would include the ability, in some sectors, to sign up to the same contingent equity obligations and be acceptable to funders on the same funding terms as bid. In the unlikely event that third party equity providers could not accept the established terms, the preferred bidder should not be required to alter the terms to incorporate a third party equity provider.

Timing of the competition will be important. Bidders are significantly exposed to process risk leading up to financial close, facing the possibility of additional costs being incurred if financial close is not achieved in an efficient and timely manner. An equity funding competition would necessarily add time to the

programme to financial close, as the documents would have to be in a near final position to allow review and limit the risk of negotiation post selection. Senior funders would need to know the identity of the winner in order to complete their credit approval process – some may not start their process before knowing. Authorities should allow time for equity competitions in their procurement timetables.

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

We would again question whether, in the absence of substantial future pipelines, HMTCo sales at any point post financial close will bring new investors into the market; particularly given the capacity in the existing secondary market.

We would want the right to pre-empt HMTCo equity sales during the Lock in Period (but without pre-emption provisions operating at any other times - see Question 7 below).

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 would expect that the working capital requirements of the project would be built into the base case funding structure at financial close, potentially incorporating the use of working capital debt facilities and for the project run to be on a limited recourse basis.

Where there is a need for contingent equity, particularly in relation to potential downside risks, we would expect all investors to accept their pro rata share as otherwise the risk profile of different investors would not be the same. If investors have different risk profiles this is likely to result in different incentives and motivations which could lead to divergent behaviour (or dispute), especially at a time when those projects risks that might require contingent equity start to materialise. Clearly, in situations where investors had different risk profiles then this should be reflected in different levels of return.

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 agree with the principle that equity and subordinated debt should not be sold separately, and that stapling can be achieved if properly structured.

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

Our preference would be to dispense with pre-emption rights altogether other than in connection with any HMTCo disposal prior to the expiry of the Lock-In Period. The presence of pre-emption provisions extends and has a tendency to complicate the process of sale.

If the pre-emption rights do remain we would welcome the shortening of the period between the issue of the Transfer Notice and the completion of the sale.

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

We would be willing to accept a deemed transfer provision provided that:

- default is limited to insolvency and material breach of obligations under the Shareholder Agreement and/or the Equity Subscription Agreement (including events in connection with any credit enhancement supporting each shareholder's subscription obligation which materially and adversely affect such credit enhancement);
- default linked to insolvency (or other analogous processes) are triggered by events which have or are likely to have a material and adverse affect on the Shareholder's ability to discharge its obligations in connection with the Project (in this respect we would question whether limb (c) of the Event of Default definition as drafted represents a hair trigger; and
- default linked to material breach provides a reasonable cure period before the Shareholder is in default.

As drafted we have concerns in relation to limbs (i) and (iii) of limb (e) and their exact relevance to the project.

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

No comments.

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 are content with the proposed arrangements for nomination and composition of the Board of Directors and, subject to the following, are content with the quorum and voting arrangements. In relation to Directors' voting rights we would prefer that the Directors voting rights be pro rata to the holdings of Shares of their respective Shareholders. This arrangement would, we believe, provide greater flexibility to cater for the different permutations that will no doubt arise in connection with the number of investors associated with individual projects and the investment interests of investors.

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

Yes.

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?

Provided that the confidentiality undertaking to be given by the observer is sufficiently robust we have no objections regarding the proposed arrangements either (a) when HMTCo is a shareholder or (b) thereafter.

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 Reserved Matters appear to be comprehensive and in broad terms reflect what we would usually anticipate. There are a number of additional Reserved Matters which are often provided for:

Additional Board Reserve Matters	Additional Shareholder Reserved Matters
Change of registered office	The creation (including by subscription or the purchase of any shares or any interest, right, power or option in respect of any shares) or disposal of any subsidiary
Appointment/removal of the Project Company's Representative	
The termination of any material project document	
Any variation to any material project document	The giving of any guarantee or indemnity
The waiver of any material rights under or in connection with any material project document	
The commencement, settlement or abandonment of any claims or proceedings above a minimum financial threshold other than debt collection conducted in the ordinary course of business	
The adoption of any changes to the accounting policies, practices or methods	

Additional Reserved Matters may also be required on a project specific basis.

Given the restrictions on disposal and the pre-emption provisions we are unclear as to why Reserved Matter B10 would be required.

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.

Yes.

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

The procedure is acceptable.

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

We have no material objection to loan stock being unsecured however our preference would be to allow the shareholders the flexibility in each case to determine whether there are reasons (project specific or otherwise) which justify the securing of loan stock.

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?

Investors who do not take bid cost risk should earn a lower return than those that do. See earlier comments under Question 4(b). There are different ways of structuring this and we would be happy to have a more detailed discussion on this subject.

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.

No further comments.

PF2 Consultation – Barclays Infrastructure Funds Response

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

- It is helpful that TPEU do not require full due diligence at bid submission stage however it is difficult to comment in detail without visibility of the Equity Bid Information sheet.
- Further clarity regarding HMTs requirements would be helpful. For example, will TPEU be able to require a minimum level of risk transfer/security from the supply chain and can TPEU negotiate the terms of its equity participation?
- How will confidentiality regarding the bid information of each bidder received by HMT be ensured?
- There may be an additional cost of providing reliance on due diligence reports to TPEU, will there be costs provided for this?
- If HMT declines to participate in a project at PB stage this could send a strong signal to funders still involved in evaluating their investment/lending into the project. As such, it would be helpful if HMT could be transparent as to their reasons for declining to invest.

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 from dialogue with the Authority.

- If HMT does decide that it will not invest the Developer will be responsible for ensuring that it can fund the full equity amount required for the project. As such, early indications of HMTs intentions and clarity on how HMT will decide whether it will or will not invest would be helpful to bidders.
- It would be useful to understand: (i) how confidentiality will be maintained if multiple bidders request advice from TPEU – will information barriers be put in place; and (ii) the degree of reliance Developers can place on the guidance provided by TPEU if the guidance is not binding

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

- The requirement for information to be provided in respect of the project for the purposes of transparency is well understood and we are in the process of including this SOPC drafting in a number of projects at bid phase. Our concerns include:
    - The resource requirement from the SPV in responding to Freedom of Information requests and the number of requests that could be generated.
    - Confidentiality agreements that we have in place with investors in our funds/other third parties that may preclude the required information from being disclosed.
- Further clarity on how TPEU intends to use the information that is disclosed under the transparency requirements would be welcomed as clearly many elements of the information pertain to the commercially sensitive elements of a given bid.

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

- **Equity funding competition post appointment of preferred bidder?**

  We welcome the fact that the equity funding competition will be run by the Preferred Bidder. Further clarity on how HMT will be involved at this stage (i.e. rights of veto etc) would be welcomed.

  It would be useful to understand how an over or under subscription for the third party equity elements will be dealt with and whether HMT will be prescribing any evaluation criteria to the Preferred Bidder.

  We are unsure about the attractiveness of PF2 investment opportunities to investors new to the UK PPP market at this stage in the procurement process. To do so will require a substantial scale of opportunity and a clear opportunity for such investors to diversify PF2 project risk. Connected to this point is the obvious need for an equity competition only to be applied to projects of sufficient size in order that the benefits of such competition in reducing overall cost of capital clearly outweigh the incremental cost of such a process.

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

  We would not have any objection to HMT reducing its equity post Financial Close however would welcome a discussion on the universe of investors that HMT could potentially dispose of its equity to and what level of veto the existing shareholders in the SPV will have. Would existing shareholders' pre-emption rights apply to a sale of HMT equity during the lock-in period?

  We believe there may be viable opportunity to draw new investors into the market through sale of a portfolio of HMT equity post financial close.

Q5. 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 see a problem with future working capital being provided by the developer provided there the risk of recovery on working capital provided is adequately remunerated and the quantum of working capital required is within reasonable boundaries.

Q6. 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 should be acceptable however should the typical structure of a PF2 project evolve such that a lower gearing is more typical (eg 75:25), this may present greater opportunities for selling subordinated debt as a discrete asset and therefore should be considered on a case by case basis.

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

- The pre-emption provisions are typical to what one would expect to see in the sector.
- Share transfers within groups of companies are permitted and this approach is welcomed.

- The definition however of HMT Co Group is very wide, encapsulating public bodies, which could lead to share transfers to bodies wholly unconnected to IUK, HMT or government departments. The reference would benefit from being narrowly defined.

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

- Clause 9.6 suggests that a non-defaulting shareholder may nominate a Suitable Third Party to take up its share of the defaulting shareholder's equity following a competition which would appear to negate the impact of Clause 9.5 and may expose the remaining shareholders to co-shareholders whom are unknown.

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

- None

Q10. What are you 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 15% shareholding necessary to trigger the entitlement to appoint a director is considered realistic; taking account of the type and quantum of equity investors expected in a PF2 project it appears appropriate. However the % shareholding should be considered on a case by case basis to ensure that there is an optimum number of shareholders appointed.

- It is considered helpful to ensure that each equity investor has a director.

- There is no limit on the appointment of alternate directors. This flexibility is welcomed but it raises questions of continuity – if an alternate director has insufficient knowledge of the project then this could cause operational discontinuity. Consideration could be given to restricting the number of alternate directors or ensuring that they receive appropriate information about the project.

Q11. Do you agree with the provision relating to the chairman?

- Yes, we see that on projects of a particular size/nature the appointment of an independent chair can be of value, in respect of co-ordination between shareholder and liason with the procuring authority.
- What is the rationale for the developer not being allowed to make the initial appointment of the chairman? We would disagree with this position.

Q12. Regarding the appointment of an observer, do you have any objections regarding the proposed arrangements

- **when HMTCo is a shareholder; and**
- **thereafter?**

- We would propose that a more effective way of achieving improved communication and understanding of operational working between the public sector client and the project SPV would be through regular liason meetings with a pre-agreed agenda. We have seen that such meetings can work effectively for both parties.
- Our concerns with regards to the observer appointment are that there is potential for the Board to become a two-tier meeting should there be an external party attending and could result in a level of resentment should the Board require the observer to step out.

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 reserved matters list appears to be acceptable. We do however have the following comments:

- In terms of approving changes to the dividend policy, it is unclear why this should not simply be a matter for unanimous Board approval. If the Board is allowed to approve payment of dividends on the basis of a unanimous decision it would seem consistent to allow a unanimous decision of the Board to approve a change in dividend policy.
- Unanimous shareholder consent is needed to increase SPV indebtedness. The effect of this is that the SPV could be prevented from quickly effecting any remedial action to cure a project default as it would have to wait to receive shareholder consent before acting.

Q14. 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.

- In our view the conflict provisions offer a practical solution which is reasonable and not too cumbersome to operate in practice.

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

- We would expect that in practice shareholders would work together to achieve a reasonable outcome and would suggest that in the first instance there is an obligation on each shareholder to aim to achieve a solution acting reasonably.

Q16. Do you agree that shareholder loan stock should be unsecured?

- This is standard market practice however as per the answer above, if gearing structures change over time it may become appropriate for shareholder loan stock to assume a second ranking charge.

Q17. 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?

- It is our view that it would be fair to reward the "developer" with a rate of return commensurate with the risk taken through investing costs throughout the bidding process as is standard for primary investors in this sector.

  Whilst we welcome the fact that there will only be one class of shares, a differential IRR could be achieved via a differential sub debt coupon or a premium paid to subscribe to sub debt by investors coming in at the PB stage.

  The UK PPP market has rewarded such risks mainly through reimbursement of development costs (plus a competitive premium) from successful projects rather than a differential return on investment. In the context of an equity competition which may or may not deliver additional equity investment to displace developer equity at financial close, we believe it would make sense for a substantial part of the developer return to continue to be reimbursed in this way.

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

- As a financial investor with considerable experience in bidding PPP projects alongside other sponsor partners from the outset of the bidding process, we continue to be interested in participating as a developer in consortium with other partners. The draft documentation proposed for PF2 does not recognise that bidding consortia may compromise different members with different roles who typically come together as discrete shareholders of a corporate entity – the project SPV - post PB. There will be more than one developer entity in the SPV under such circumstances. We suggest that the documentation be reviewed and amended to reflect this dynamic in the bidding process.

SUBMISSION BY CARILLION TO HM TREASURY ON NEW PF2

- Carillion fully supports public sector equity participation in PF2 projects and we proposed this as part of our PF2 consultation submission.

- We believe it is important that the mechanism for such participation continues to incentivise the private sector to invest in PF2 projects. This can be achieved by ensuring that:

    - the Treasury PF2 Equity Unit sets out, at the start of the procurement process, its intention to invest equity and its proposed percentage investment;

    - sponsors who take the risk of bidding projects (e.g. bid costs, resource commitment), retain the right to invest a meaningful proportion of the equity - we would propose 50%;

    - the approach recognises the value of allowing the early alignment of interests between private sector investors (whether industry or financial). This includes:

        i. sharing bid costs - for example, allowing sponsors to partner with financial investors who share a portion of the bid costs, and
        ii. combining delivery experience - for example, allowing a number of industry sponsors to form a consortium, each with a meaningful equity stake;

    - the introduction of public sector equity does not materially increase the cost/risk to sponsors of projects or impose onerous due diligence requirements on them. Nor should it add complexity to the procurement process

- We would, therefore, encourage HM Treasury to invest equity in PF2 projects but to allow the private sector to determine the best way of raising the remaining private sector equity required for the project.

As one of the UK's largest construction and support services organisations, Carillion is transforming the delivery of infrastructure and buildings. We have annual revenue of around £4.4 billion and employ some 40,000 people across Britain and in Canada, the Middle East and North Africa. We have a portfolio of award-winning work in areas vital to society: defence, education and regeneration, power, utilities, road and rail. From first concept through design to construction, commissioning and operational support, we provide safe, high quality, cost effective and sustainable solutions, tailored to the needs of our customers.

Our key capabilities include: civil and structural engineering and construction; building construction; project management; facilities management; mechanical and electrical engineering; utilities; civil, structural and architectural design. Carillion is also the largest private sector provider of construction apprenticeships in the UK, training over 1,000 apprentices each year through a number of dedicated training centres.

For further information about Carillion, please visit our website:

http://www.carillionplc.com/

H.M. Treasury consultation on the terms of public sector participation in PF2 Projects

A response from CMS Cameron McKenna LLP

Background to the respondent

CMS Cameron McKenna LLP is a London headquartered international law firm, with a particular focus on infrastructure and project finance transactions – both in the United Kingdom and internationally.

In putting together its response to this consultation, CMS Cameron McKenna LLP has sought views from a range of clients and contacts in the PPP/PFI industry – but the views expressed in this response are those of CMS Cameron McKenna LLP.

General considerations

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

- The proposed structure does not seem to envisage that a sponsor would bid a project in conjunction with a third party equity provider (unless this is via an SPV between the sponsor and third party equity provider). If bids are structured in this way, the arrangements for the equity funding competition would need to take account of that aspect. Third party equity providers will not want to take exposure to bid costs unless they have a reasonable prospect of reaching financial close. Perhaps, as has been used in debt funding competitions, a right to match the selected funding solution, of up to 50% of the funding requirement (excluding the Treasury's allocation) could go some way to addressing such a concern.

- The structure contemplates a three party shareholders agreement, with a single class of shares (though more than one class of loan notes is envisaged). More complex equity financings will require a bespoke solution, which would need to be agreed with the Treasury team. Where there is a bidding consortium, the consortium members will usually not want to structure their own arrangements through an SPV, and there should be some flexibility here.

- Project advisors have typically not provided specific reliance letters to sponsors/investors, who have tended to rely on the duty of care owed to the project company and the retainer with the project company/sponsors.

- The basis on which lenders' technical and insurance advisors may owe a duty of care to investors will need to be agreed – sponsors often have very little influence over this.

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.

- Whilst the availability of informal guidance is welcome, sponsors may well seek a more formal response to provide more certainty on the development of projects.

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

- Investors may have some concerns with Part B of schedule 7 – and in particular may want greater certainty on the timing of any disclosure under paragraph B3 to address relevant regulatory regimes over the disclosure of price sensitive information.

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

a) Equity funding competition post appointment of preferred bidder?

- The bid costs aspects of this need to be addressed – and how the original sponsors will be reimbursed.

- The timing of the equity funding competition – and how this fits in with the development of the project (and the process of selecting, and engaging with, senior lenders) – is a key aspect. The consultation is not clear on this – and it seems likely that senior lenders will want certainty about the composition of the consortium prior to their final credit sign off.

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

- The need for HMTCo to sell equity down during the Lock in Period in unclear – why should there not be equality of treatment here?

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 that this will arise on many projects. The structure for providing working capital seems a little simplistic – in any event using a single SPV for multiple projects would be unusual, and if that approach was adopted surely the structure would be agreed based on the specifics of the transaction.

- Where there has been a requirement for deferred or contingent equity for projects, this has usually been provided by all shareholders on a pro rata basis.

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)?

- Generally yes – though the tax impact of this will need to be addressed and some PFI/PPP equity investors do have separate group vehicles to hold equity and debt instruments, which should be permitted.

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

- The transfer rights in favour of Treasury are extremely wide. There may be concerns if shares are to be transferred to the sponsoring department of a project (for example if there were to be disputes or claims under the project agreement and/or sub-contracts at the relevant time) and the relevant definition would allow the Treasury to transfer its shares (without pre-emption) to a fund in which it held a very minor interest.

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

- There does not seem to be a settled view of this in the market – insolvency related events, failure to provide committed funding, and breach of transfer restrictions, are the most common events, but general breaches of the shareholders agreement and external events (such as paragraph (e) of the definition) are not common and likely to be controversial. The expropriation related event seems rather inappropriate on the context of a public sector driven provision for UK PPP/PFI projects.

- It is conventional to apply a discount to the value of equity on a deemed transfer for default (other than insolvency) – but it would seem that all deemed transfers for default are to be at an agreed value – or if no value can be agreed, market value.

Question 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)

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 percentage level at which directors are appointed does vary from project to project, and it would seem sensible to allow a range here.

- Directors' voting is often linked to the shareholding percentages represented by directors (and not numbers of directors) and there should be some flexibility here.

- The mirror board structure may not fit in with a desire of some sponsors to keep day-to-day operational matters at SPV level, and more substantive matters reserved to the Holdco board – which can arise for larger projects (or where the Holdco has a large board) – and there should be some flexibility to consider this in appropriate cases.

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

- Sponsors have differing views on this.

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?

- It is not clear who the HMTCo observer might be – and investors may have concerns if, for example, the observer role were to be provided on an "out sourced" basis by a competitor. This may be unlikely but the only requirement in relation to the appointment is consultation with the sponsoring department. Would consultation with the other shareholders not also be appropriate?

- There may also be sensitivities with having a representative of the sponsoring department attending board meetings in an observer capacity – and whilst the SHA contemplates that the observer could be excluded from parts of meetings, it may be sensible to have a form of engagement letter for the 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.

- The list is reasonably standard – but it is unusual for all these matters to require each shareholder's consent – it would be more conventional for a limited number of key matters to require each shareholder's consent, and the wider list to be subject to a minimum shareholding level.

- Reserved matter B10 is unusual – and fits oddly with the rights of first refusal clauses. Is this appropriate as a general veto matter, as presumably it is driven by a public sector concern?

- The materiality level for reserved matter B11 would typically be considered in the context of each project – fixing it at £100,000 seems a little arbitrary. These monetary amounts are also usually subject to indexation (in the same way as under the project agreement).

- Reserved matters C7 and F1 are unusual – and as drafted leave uncertainty as to what they are seeking to cover. It would be better for specific provisions to be developed to address the concern in the context of the relevant project. They also cover similar areas but are not drafted consistently.

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.

- The opt-out mechanism is unconventional and it is not clear why this is required.

- Not all sponsors favour step aside provisions for conflicts of interest – particularly where there is a small board and the directors with day-to-day operational knowledge may often be those nominated by the sponsors. If step-aside provisions are essential, they would need to apply at a later stage (i.e. when there is an actual dispute).

Dispute resolution (SHA Clause 11)

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

- This seems pretty conventional.

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?

- These costs have in the past been shared between equity investors, and have not typically been addressed through a bidder premium.

- Having a different rate of interest on loan stock may also give rise to a less straightforward approach to secondary market transactions.

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.

- The loan notes are to be issued by the SPV direct to the investors (rather than to the HoldCo with back-to-back loan notes issued by the HoldCo) – this may not fit in with a number of sponsors' preferred structure.

- Having loan notes issued by the SPV direct to investors which need to be charged in favour of the project lenders (as part of the lenders standard security package) has in the past caused issues with negative pledges in sponsors' own financing agreements, and was one of the main reasons for having all the sponsors' investment – equity and loan notes – routed through the holding company – a similar issue will inevitably arise here.

CMS Cameron McKenna LLP
21 August 2013