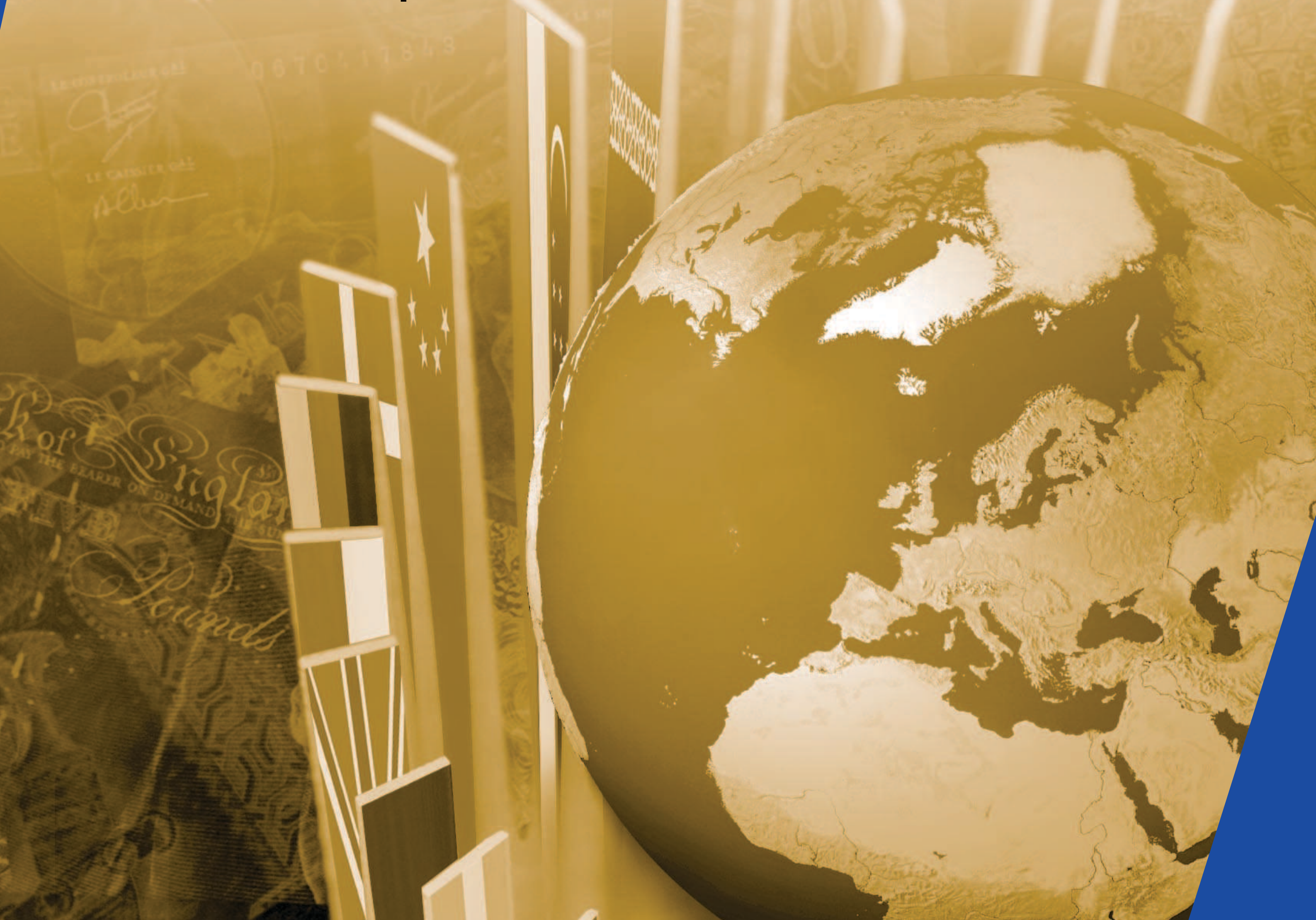
C/M/S/ Cameron McKenna

PFI secondary market

The emergence of the PFI secondary market is viewed as a natural progression of PFI. CMS Cameron McKenna's award winning project finance/PPP practice combined with its leading M&A practice, places it in a strong position to advise clients as they consider the benefits of the secondary market.

- **What is the PFI secondary market?**
- **Issues**
- **How can we help?**
- **Relevant experience**
- **Contact point**



C/M/S/ Cameron McKenna

Legal Business Awards 2002 WINNER

Project finance/PFI team of the year

infrastructure JOURNAL

Law firm of the year - Transport award 2001

PUBLIC PRIVATE FINANCE AWARDS*2001 WINNER

Best International PPP Project

What is the PFI secondary market?

As the UK PFI market matures and more projects reach their operational phase, a secondary market for private finance equity is gaining momentum.

On construction completion the risk profile of a project reduces thereby increasing the value of the original equity investment, making divestment an attractive option for both financial investors and commercial players actively managing their investments. Of the approximately 530 PFI projects signed to date it has been estimated that 65% have reached construction completion and moved into the operational phase, with many more projects being forecast to complete over the next two year period.

Gains realised by construction firms, service providers or financial investors selling their stake in a project can be used to offset losses from unsuccessfully bidding for other PFI projects or to provide capital to invest in new schemes.

The market for such investments is estimated to be worth £2 billion, with secondary market funds already being established to invest directly in existing projects. While precise investment parameters will be specific to individual funds, the secondary funds are expected to take relatively long term positions in investments which offer post-construction risk yields and which do not necessarily have substantial embedded refinancing upside.

The PFI secondary market can also extend to the securitisation by operating shareholders of their equity cashflow. In addition, it has been suggested that purchasers in the PFI secondary market may seek to create specific sector units which may be listed in the future.

There is therefore good reason to suggest that there will be considerable movement within the equity ownership of PFI projects in the near future and, in particular, many see the sale of equity investments as a natural progression of PFI.

"...many see the sale of equity investments as a natural progression of PFI."

Issues

For those who wish to participate in the PFI secondary market there are various issues to consider:

- Tax – there are a number of important tax issues on the structure and financing of the acquisition vehicle (certain advantageous arrangements may be appropriate, for example, for US acquirers). Additional tax considerations apply to the sale and purchase of the interests in the SPV, together with interests in any other SPVs which have the same shareholders. In particular, purchasers and sellers should seek to ensure the continuing availability of tax losses, maximise CGT exemptions and minimise stamp duty costs.
- Due diligence – purchasers should consider when undertaking due diligence on existing PFI documentation that extensive due diligence will have already been undertaken by the shareholders of the SPV and, more importantly, the SPV's senior lenders to obtain credit approval. Existing risk matrices should also enable purchasers to take a commercial approach to due diligence. Further, it is likely that most sale and purchases in the secondary market will occur following construction completion when construction risks will have reduced.

  Purchasers acquiring an equity interest in an SPV in the secondary market need to consider the motives of the seller, whether it is a commercial shareholder or a financial investor. In particular, purchasers should look at ongoing sub-contracts with a fresh critical eye if the seller has an ongoing sub-contract. Similarly, shareholder documentation should be carefully reviewed as the rights of a selling minority shareholder who is a sub-contractor may not be appropriate for a purchaser.
- Documentation – although a purchaser in the secondary market will be buying into an existing PFI, documentation required will include:
  - sale and purchase agreement
  - tax deed (if acquiring equity)
  - disclosure letter
  - new loan instrument (possibly).

If an equity interest is being acquired, shareholder documentation will need to be amended, bearing in mind those issues which arise out of due diligence.

- Change of control – due diligence will reveal those consents that a seller will need to obtain prior to selling its equity stake. In particular:
  - bank's consent under the banking documentation
  - authority's consent under the project agreement
  - shareholders' consent under the shareholder documentation.
- Banking – due diligence on the banking documentation will be necessary. Consideration should, in particular,

be given to the provisions on early repayment, the consequences of late payment and refinancing. Early project agreements are less likely to have a refinancing gain share clause, although the refinancing 'Code of Conduct' launched by OGC in October 2002 has provided clarity for such projects.

Where a purchaser is entering into a new subordinated debt instrument, purchasers should be aware that senior lenders may wish to extend any existing intercreditor/subordination arrangements.

How can we help?

Our leading PFI/PPP team can provide a full legal and tax service by undertaking the M&A aspects of a transaction in the PFI secondary market; we have substantial experience in the structuring and negotiating of a large number of acquisitions. Our lawyers have been working on PFI/PPP projects since 1995 and are familiar with the issues and risks inherent in such projects within the differing sectors and will provide commercial advice on transactions. Transactions within the PFI secondary market may include the disposal of project assets, variations to project documentation, and/or possible restructurings and refinancings.

We are experienced in the procurement of projects through public works programmes and private sector financings under the PPP/PFI framework. We have advised lenders, third party equity investors, sponsors, governments and other state entities, contractors, O&M and F.M. providers, insurers and consultants on a wide range of projects in the following sectors:

- health
- education
- law & order
- defence
- accommodation
- sport & leisure
- rail
- roads
- infrastructure
- electricity
- gas
- water
- oil
- telecoms & IT

Our team is experienced in these areas as set out below.

Relevant experience

Examples of current or recently closed projects and M&A transactions include:

PFI/PPP

- **London Underground Limited PPP** - Acting for the Metronet Consortium on all aspects of the deep tube and the sub-surface lines packages in relation to the LUL PPP, which is one of the largest and most complex PFI/PPP projects undertaken to date.
- **Radio Communications Signal Service** - Acting for Alert Communications Limited on its successful bid to provide to the Ministry of Defence a radio communications signal service between Command HQ and Britain's front-line submarine fleet.
- **National Air Traffic Services** - Acting on the sale by the Government of a 46% interest in the NATS businesses to the Airline Group (a consortium of UK airlines), and representing lenders who arranged and underwrote the financing for the acquisition and the ongoing capital expenditure programme and operational requirements on the first private management for an air traffic service anywhere in the world.
- **Walsgrave Hospital** - Acting for The Coventry and Rugby Hospital Company plc on the £372m project funded by a listed wrapped bond. This will be the largest new NHS hospital to be built for 30 years and it is also the first project to use the Retention of Employment model, enabling NHS employees to retain their public sector employment related benefits, while they are seconded to the private sector.
- **North Tyneside Schools/Ealing Schools PFI Projects** - Acting for the Bank of Ireland and Sumitomo Mitsui Banking Corporation respectively on the funding for Kajima project vehicles for two multi-school projects in North Tyneside and Ealing.
- **A130 - DBFO Road Project** - Acting for the private sector sponsors for this £111m project (funded by commercial bank and EIB debt) for a 15km trunk road on a shadow tolled basis in Essex which was the first Local Authority DBFO road project.

"Commended for its clear focus on the international corporate market" *(Chambers 2002 - ranked number 1 for mid-market M&A)*

Chambers Global Energy
Law Firm of the Year (Power) Award, 2001
CHAMBERS

Energy team of the year (Power) Western Europe

GLOBAL FIN@NCE

Project finance winner 2001

ProjectFinance

European PPP deal of the year 2001

C/M/S/ Cameron McKenna

Refinancings and Variations

- **Channel Tunnel Rail Link** - Acting for the UK Government on the refinancing of a £700m commercial debt facility. The refinancing also included a variation and associated amendments to the Development Agreement.
- **M40 DBFO Road Project Refinancing** - Advising UK Highways on the refinancing of the commercial bank facility for this project.
- **LUL Powerlink** - Advising the commercial banks and EIB on the provision of £45m of additional debt for a major variation to the project.
- **Bridgend Prison Refinancing** - Advising the project company on the refinancing of the existing commercial bank debt and a wholesale equity restructuring.
- **SELCHP Refinancing** - Advising the project company on the £100m bond refinancing of the waste to energy PFI project.

Restructurings

- **The restructuring of the Channel Tunnel Rail Link** - Acting for the DFT in relation to the detailed operational arrangements for the link, a potential funding of the purchase price for Section 1 by securitisation, a deferred grant securitisation and a further bond finance exercise to fund the construction of Section 2.
- **Restructuring of Railtrack plc (in administration)** - Acting for the UK Government in the first-ever application under the 1993 Railways Act. The team has also been assisting on the development of options for the operation of the network during the administration and the issues arising from the proposed subsequent transfer of the business under a transfer scheme. This transfer has now taken place, with Network Rail being the replacement operator.

M&A

Examples of our mid-market experience is shown below.

- **Laing Property Developments** - Acting on the £40m sale of Laing Property Developments Limited to Kier Developments Limited.
- **The Cooper Companies** - Acting on the £68m acquisition of contact lens company Biocompatibles Eyecare – operations in UK, US, France, Spain, Italy and Australia.
- **Nestle UK Limited** - Acting on the £145m acquisition of Northern Foods Ski and Munch Bunch yoghurt brands.
- **Legal & General Ventures** - Advising on £137m sale of a stake in Young's Bluecrest.
- **Enterprise Inns Plc** - Acting on the £875m acquisition of 1860 pubs from Laurel Pubs Holdings financed via a rights issue.
- **ABN Amro Private Equity (UK) Limited** - Advising on the MBO of Commodore Shipping Company Limited.

Contact point

For more information on the PFI secondary market, please contact:

Sandra Rafferty - Partner
T +44 (0)20 7367 2804
F +44 (0)20 7367 2000
E sandra.rafferty@cmck.com

Trevor Butcher - Partner
T +44 (0)20 7367 2517
F +44 (0)20 7367 2000
E trevor.butcher@cmck.com

Jason Davies - Partner
T +44 (0)20 7367 2194
F +44 (0)20 7367 2000
E jason.davies@cmck.com

We have an extensive resource within the firm and many partners involved in PFI and M&A are recognised as leading individuals by the leading legal directories.