21 August 2013

Our ref: ICAEW Rep 110/13

PPP Policy Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

PF2equity@hmtreasury.gsi.gov.uk

Dear sirs

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

ICAEW is pleased to respond to your request for comments on *Consultation on the terms of public sector equity participation in PF2 projects*.

ICAEW has a keen interest in the range of skills that are required to deliver successful public private partnership programmes. We would be delighted to provide assistance to HM Treasury to ensure that the public sector can access the right mix and balance of skills that are required from the start, ie at feasibility stage, and throughout the lifetime of a project.

Please contact me should you wish to discuss any of the points raised in this response.

Yours faithfully

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ICAEW REP 110/13

ICAEW REPRESENTATION

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

Memorandum of comment submitted in August 2013 by ICAEW, in response to HM Treasury's consultation paper, *A new approach to public private partnerships: consultation on the terms of public sector equity participation in PF2 projects*, published in July 2013.

Contents	**Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Consultation on the terms of public sector equity participation in PF2 projects* published by HM Treasury on 10 July 2013, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Corporate Finance Faculty is the voice of corporate finance within ICAEW. The faculty is responsible for submissions to regulators on behalf of ICAEW. It provides a range of services to its members including a monthly magazine *Corporate Financier*. Members of the faculty, a network of some 6,000 corporate finance professionals, have contributed to this response.

5. ICAEW's international capacity building work involves close working with counterpart bodies, financial regulators and governments in developing countries to strengthen the institutional capacity and the capacity of the accounting profession. We now have undertaken more than 20 projects in Asia, Africa and Europe. Recently the UK Foreign and Commonwealth Office approved the funding of a joint ICAEW-Myanmar Institute of Certified Public Accountants project. This project will involve the development of a strategic plan for strengthening the accountancy profession in Myanmar and delivery of training and workshops on international standards, audit quality assurance and professional ethics.

MAJOR POINTS

Support for the initiative

6. We are supportive of the government's policy to invest equity in PF2 projects. As set out in our response to the recent European Commission green paper on long-term financing of the European economy, we believe there is a role for greater involvement by institutional investors in the provision of long-term capital goods such as capital projects and public sector equity participation can help attract institutional interest. We would be interested to understand who HM Treasury considers is a potential third party equity investor, how it has assessed such investors' ability to appraise and evaluate participation in this asset class and what the implication of this will be on the required return. If, after public sector participation, the size of the stake in PF2 projects is likely to be small this may not be attractive to many long-term investors and, to address concerns such as this, it would be important for that assessment to be disclosed.

7. The primary objective of public sector equity stakes could be more explicit: is it to reduce the cost of equity or to widen the pool of equity investors who will invest in PF2 projects?

8. Other aspects of the government's policy also remain uncertain, such as the type of projects the public sector might take an equity stake in or on the grounds for not participating. The basis for the government deciding to reduce or sell its investment is also not clear (see our response to Question 1). Clarity on the objective of the observer role would also be welcome;

for example, is it to protect the public interest at a local, or a national level (see our response to Question 12)?

9. We believe that the process for encouraging third party equity investment could be simplified so that one process is in place for the public sector and other third parties to bid (see our response to Question 4).

10. We question whether the public sector can be considered to have equal shareholder status if it cannot be called upon for additional working capital or shareholder capital (see our response to Question 5).

RESPONSES TO SPECIFIC QUESTIONS

General considerations

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

11. The proposed investment appraisal arrangements lack the high-level criteria or reference to policies that we would have expected to see. The consultation paper does not elaborate on the type of projects the public sector might take an equity stake in or on any grounds for not participating. There is no indication of how the level of public sector equity participation will be determined or of the basis for a reduction in or sale of the public sector's stake. Prospective bidders would reasonably expect to understand such details in the investment appraisal.

12. Regarding the proposed due diligence arrangements, we believe that if the Treasury PF2 Equity Unit communicates its needs upfront it might generally rely on the primary equity providers to incorporate those needs in the scope of their due diligence. This would be preferable to the Treasury PF2 Equity Unit repeating work that has already been undertaken. We would be happy to discuss how we recently supported a government department and third party due diligence providers with determining the scope of due diligence.

13. We also find certain elements of the proposed diligence arrangements unhelpfully vague. For example, bidders will be interested to know the minimum documents that the Treasury PF2 Equity Unit will expect to see during due diligence. Moreover, once the documents are available, what timetable will the Treasury PF2 Equity Unit commit to for providing an decision on whether it will invest or not? The pace of this decision may be a factor influencing the provision of third party equity investment.

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.

14. We refer to our answer to Question 1 which sets out areas that should be addressed in any guidance.

15. Arrangements for giving informal guidance during procurement may be of some benefit to bidders. Such arrangements should not, however, provide a basis for potential procurement challenges which could be the case when such guidance is separate from the dialogue with the Authority.

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

16. We agree that transparency of information is a key principle for successful joint ventures and for enhancing the parties' understanding. However we would be concerned if transparency in this case could mean making commercially sensitive information available to the public, including to competitors. For instance, we don't think that the equity backers of losing consortia should be entitled to full details of the winning bid.

17. On a related matter it is important to ensure that appropriate skills exist within HMTCo to be able to analyse the Transparency Information and assess the performance of the investment. In its contribution to the call for evidence on reforming the Private Finance Initiative, ICAEW commented on the need to learn lessons from the absence of capability and skills in PFI projects such as the Highway Agency's project to widen the M25 and the Ministry of Defence's Future Strategic Tanker Aircraft project. The project management skills and financial capabilities required for successful set-up and delivery of public private partnerships, such as future PF2 projects, need to be in place from the feasibility stage and throughout the lifetime of the project.

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)?

18. We wonder whether HM Treasury has considered the option of all interested investors, including the public sector, being invited to bid simultaneously for their desired level of equity as an alternative to the proposed process whereby a third party equity investment competition would follow the public sector stake. We would like to understand the perceived advantages of the proposal, in particular as the first option would be quicker and would avoid the risk of delays and late variations to the terms which would have an impact on the timeframe.

19. Regarding a), we believe that the intention to provide the same due diligence information as that provided to the Treasury's PF2 Equity Unit, while appearing cost efficient, will not avoid altogether extra costs from running a competition and may not be acceptable to bidders, eg if other PF2 competitors are approached.

20. Regarding b), we believe that the basis for HMTCo deciding to reduce or sell its investment should be made clear and consideration made of the resulting governance implications (observers having to deal with changing directors). Clarity on the primary objective for public sector equity participation in PF2 projects, as we suggest in paragraph 7, would be helpful on this point.

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.

21. The proposed terms provide that the public sector would not be required to provide additional funding such as shareholder loans and working capital for the ProjectCo. We are not persuaded that equity investors or Senior Funders should not provide working capital. As a co-investor in a project on the same terms as the private sector, the public sector should be prepared to have exposure to the downside if a project gets into difficulties and this risk will influence the investment appraisal. In this context we disagree with SHA Clause 4.2(a).

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)?

22. We agree.

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

23. We agree with the provisions.

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

24. We agree with the provisions.

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

25. We have 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?

26. We broadly agree with the proposed arrangements for nomination and composition of the Board of directors although we observe that a 15% shareholding is a low limit to warrant the right to nominate a director. A odd number of directors is likely to be necessary as the chairman has no casting vote and there are situations where a majority of votes are required for a decision (SHA 5.5(a)(i)(B) and SHA 5.6(d) and (e)).

27. We would be pleased to discuss how ICAEW might help the public sector to promote understanding of the responsibilities and duties of directors of special purpose vehicles (SPVs) to ensure effective governance.

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

28. We agree.

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?

29. We support the principle of appointing an observer which will help the sharing of good practices across projects. Subject to further clarity on the objective of the observer role (see paragraph 8) we consider that, in recognition of the procuring Authority's continuing interest in the lifetime of the deal, it would be preferable for the Authority to have the right to nominate the observer, in consultation with HMTCo.

30. Regarding the proposed exclusion of the observer where conflicts of interest arise we recommend that appropriate safeguards are implemented to prevent the risk of arbitrary exclusions, such as circumstances where an observer might be most needed. The terms could, for example, indicate the circumstances in which the Board might exclude an observer so that this can be taken into account when nominations are being considered for the post.

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.

31. We believe that the proposed provisions should be consistent with best practice as set out in guidance issued in March 2010 by HM Treasury for public sector bodies forming joint ventures with the private sector.

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.

32. We have no additional comments.

Dispute resolution (SHA Clause 11)

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

33. We believe the proposed arrangements are reasonable.

Loan Stock Instrument

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

34. We wonder whether HM Treasury has considered securing shareholder loan stock behind the Senior Funders.

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?

35. It would be reasonable to expect equity investors to contribute towards the bidding costs and other risks borne by the Developer. However we have reservations about achieving this via differential rates of return to loan stock of the same class. Less complicated ways of compensating the Developer for bid risk would include a contribution on market entry by investors to the bid costs and the Developer invoicing the SPV. It could also be left to the parties to negotiate how to compensate the Developer.

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.

36. We note that the proposals for investment appraisal by the Treasury PF2 Equity Unit and decision-making by HMTCo's Board participation will potentially result in the concentration of skills and knowledge within Treasury. It will be important to ensure that the aims of public sector equity co-investment, such as visibility of project information, improvements to partnership working and greater involvement in strategy, will not be benefits that accrue solely to the Treasury but can be shared across the public sector.

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