

## LEGAL ASPECTS OF PRIVATELY FINANCED INFRASTRUCTURE TRANSACTIONS IN NIGERIA \*

### Abstract

*Historically, public infrastructure was almost exclusively financed by governments through their budgets. However, over the last few decades there has been a near seismic shift, with the increase in the deployment of private capital for delivering infrastructure for public use. Under this arrangement, public sector entities have partnered with private investors to finance, build, operate and manage public infrastructure. This phenomenon has led to the growth of a large body of unique legal principles and structures, which have been developed to aid the structuring of these types of projects. This paper looks at some of these legal structures and rules, particularly how they are applied in practice in Nigeria.*

**Keywords:** Privately Financed, Infrastructure Transaction, Procurement, Pre-incorporation Contracts

### 1. Introduction: The Nature of Privately Financed Infrastructure Transactions

The term ‘privately financed infrastructure transactions’ as it relates to this paper, is an umbrella term that captures all the different methods employed by private sector actors in delivering public infrastructure. The uniqueness of these types of transactions arises from the fact that the private sector investor uses its funds in carrying out any or a combination of the construction, rehabilitation, operation, management and/or maintenance of the public infrastructure assets.<sup>1</sup> Therefore, it may be the case that the public assets are already in existence and that the private sector merely rehabilitates the asset or even that private sector party is contracted only to construct the asset and not to operate and maintain the asset. It is useful to distinguish privately financed infrastructure projects from their direct opposite- ‘publicly financed projects’ which is the conventional situation where governments finance the delivery of public infrastructure through their normal budgetary process.<sup>2</sup> Here, the public sector appoints private sector contractors to deliver public infrastructure according to agreed designs and specifications. The private sector contractor is then paid off for its services through the government’s purse, according to agreed terms, bringing an end to the agreement between the parties. It is important to note that contrary to some erroneously held belief, in both cases, the public sector party is responsible for paying for the delivered infrastructure. The only difference is that in the case of publicly financed projects, payment is made to the private sector almost immediately after the project is delivered whilst in privately financed infrastructure, involves periodic payments in the form of periodic user charges.<sup>3</sup>

It appears that the major distinguishing factor between a privately financed infrastructure project and a publicly financed one is basically that the former allows for more risk transfer from the public sector to the private sector. It is worth noting that risks arise in all projects whether done through traditional public procurement or through private finance transactions. It is just that in privately financed infrastructure projects parties are better aware of risks since it is shared and managed between the

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<sup>1</sup>The word ‘infrastructure’ was coined out of the words ‘infra’ (beneath) and ‘structure’ (building) and thus usually encompass services or facilities that are underground such as piped water and sewerage or those that lie on the surface such as roads and railways. See Gomez Ibanez J. A, (2003) *Regulating Infrastructure: Monopoly, Contracts and Discretion* Harvard University Press, USA p. 4.

<sup>2</sup> It does not matter whether a particular government has borrowed to finance the infrastructure, as long as the funds for the provision of the infrastructure are appropriated and disbursed in the normal manner and entire risks of providing the infrastructure remain with a public sector entity, then it ought to be classified as publicly financed.

<sup>3</sup> These charges may be in the form of availability payments made directly to the investor by the government or user fees paid by citizens to the private sector investors anytime the asset is used. User fees are technically taxes which would otherwise have been collected by government but transferred directly to the private sector investors.

contracting parties. In traditional public procurement, while it is sometimes erroneously assumed that risks are solely borne by the public sector, in reality they are merely passed on to the public as customers and taxpayers. Large-scale infrastructure projects are obviously riskier than regular projects because of the complexity of coordinating a wide range of disparate and inter-related skills and activities.<sup>4</sup> This complexity is further compounded by the fact that public sector projects tend to have multiple stakeholders whose objectives and interests differ and due also to the fact that the infrastructure is user specific.<sup>5</sup>

It is for the reasons discussed in the preceding paragraphs that a number of distinct legal rules, different types of agreements and other legal conventions have developed over the years to support transactions of this nature. The procurement and financing arrangements for these types of transactions are certainly different from those applied in conventionally procured projects and therefore require a unique set of skills from legal practitioners negotiating transactions of this nature. This paper is particularly useful to practitioners in this nascent area and serves as an introduction to the laws, rules and conventions regulating the procurement process, the setting up of the project company and a discussion of other project, relationships and financing agreements used in consummating these types of transactions.

## 2. Procurement Process

Privately financed projects are usually procured through a competitive bid process where a number of private sector parties are invited to submit bids for the right to deliver the project. In Nigeria, this process is regulated under two principal legislations: The Infrastructure Concession Regulatory Commission Act ('ICRC Act') of 2005,<sup>6</sup> and the Public Enterprises (Privatisation and Commercialisation Act of 1999 ('Privatisation Act'). These two legislations also created two institutions: The ICRC Act created the Infrastructure Concession Regulatory Commission (ICRC) and the National Council on Privatisation (NCP), with its Secretariat as the Bureau of Public Enterprises (BPE).<sup>7</sup> The BPE is principally charged with the responsibility for disposing public assets but has also carried out a number of concessions of brownfield assets, which otherwise could also have been done under the purview of the ICRC. It is worth mentioning that there is a third statute, the Procurement Act; this Act creates the Bureau of Public Procurement (BPP) which is responsible for superintending most of the traditional procurements financed through the budget.<sup>8</sup> There have been cases where management contracts and joint venture agreements have been procured vide the Procurement Act.<sup>9</sup>

Investors are allowed to bid as single entities or as a consortium of different members with different capabilities for the right to finance, construct and operate a public asset. Since the consortium is a mere aggregation of companies, it is not a legal entity and therefore incapable of suing or being sued. This arrangement would typically pose serious legal issues for the procuring authority who would prefer to deal with legal entities. However, procurement authorities also understand that these large projects usually demand disparate skills which might not reside in a single entity. To resolve this issue, the procuring authority would usually request for that the consortium post a bid bond or provide parent company or cross companies guarantees to secure the bids.

The bids themselves are normally submitted and evaluated under a two-stage competitive process. The first stage is a prequalification stage commonly referred to the Request for Qualification (RFQ) or also

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<sup>4</sup> Shen L, *et al* 'Role of Public Private Partnerships to Manage Risks in Public Sector Projects in Hong Kong', (2006) Vol. 24(7), *International Journal of Project Management* pp. 587-594

<sup>5</sup> *ibid*

<sup>6</sup> The Infrastructure Concession Regulatory Commission (Establishment, etc) Act No.18 of 2005.

<sup>7</sup> Public Enterprises (Privatisation and Commercialisation Act) 1999.

<sup>8</sup> Procurement Act, 2007

<sup>9</sup> The Management Contract for the Transmission Company of Nigeria was initially done through the instrumentality of the Privatisation Act but had to be ratified by the BPP.

known as the Expression of Interest (EOI) stage. The second stage is the Request for proposal (RFP) stage. The legal document that is important to the bidders at this stage is the Request for Proposal document. This document stipulates the bidding rules regulating the bid the process and binds both the procurement authority and the bidders.

### **3. Project Finance**

Privately financed infrastructure projects are usually financed using project finance models. In most cases projects are financed through a mixture of debt and equity. For practical reasons most lenders would like to see that the private sector party has a 'skin in the game' and therefore demand that they also invest significant amounts of their monies into the project. The capital structure i.e. the ratio of equity to debt, is determined by the lender's perception of risk around the project. As a rule of the thumb, lenders are more likely to demand a lower equity gearing from projects with more predictable cash flows as opposed to greenfield projects with less certain cash flows. Most times, the public sector procurement authority determines the required capital gearing for each project.<sup>10</sup> The reason for this is to ensure that the project is not overleveraged.

Typically, where project developers wish to raise debt to finance their projects, lenders will require some form of security to backstop the loan. The idea is that where the borrower defaults on the loan, that the lenders would have recourse to the security to make themselves whole. However, because of the sheer amount of the funds required to finance infrastructure projects and the risky nature of infrastructure finance, it is rare to have projects financed through secured financing. Consequently, infrastructure projects are financed through non recourse financing. Non-recourse financing as the name implies is a project financing structure where lenders look towards the proceeds of the project or/and the assets of the project as security for their loans to the project company. The implication of this is that borrowers under privately financed projects will have greater obligation to prove to financiers that the project will be able to repay the loan and interest when they become due.

Under a project financing model, lenders rely principally on the technical and financial project documents for assurance. Some of these documents are the feasibility studies, the environmental and social impact assessment reports, the financial models and a host of other supporting agreements. These supporting agreements include the shareholder agreements, concession agreements, guarantee agreements, operation and maintenance agreements, off take agreements amongst others. These documents and agreements are presented before financiers who make a decision on whether to fund a project by looking at them. Financiers do not necessarily require the project promoters to provide collateral or security backstopping the loans.<sup>11</sup> They simply rely on the proceeds from the project to meet the principal and interest repayments on the loans.

In practice however, there is hardly any pure project financed project that have been done in Nigeria. Most of the transactions have been financed through limited recourse financing. In this case, the lenders in addition to relying on project documents to finance infrastructure projects would also ask for some form of collateral or security which would usually be properties and even sometimes the shares in the project company.

### **Deciding the Project Vehicle**

Due to the risky nature of infrastructure projects, most investors would incorporate special purpose vehicles (SPV) to use in investing in the project. An SPV is a legal entity that is incorporated specifically for the purposes of delivering the particular project. It allows investors shield their parent companies

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<sup>10</sup> Most infrastructure projects that have been concluded so far in Nigeria have required a 70:30 debt to equity gearing.

<sup>11</sup> Note that the lenders would normally also conduct legal, technical and financial due diligence on the asset and the project promoters to validate the documents. The due diligence is usually paid for by the project sponsors.

from the project risks. It is also convenient because it is used to ring fence investment in a particular project without encumbering or diluting other investments carried out by the promoters of the infrastructure project. Since the SPV is usually a limited liability company under Nigeria law, the legislation regulating its incorporation and regulation is the Companies and Allied Matters Act (CAMA).<sup>12</sup>

#### **4. Pre-incorporation contracts**

One important issue that usually arises under these types of transactions is the status of pre-incorporation contracts. Project promoters would have entered into certain agreements on behalf of the yet to be incorporated SPV at the beginning of the project promotion process. However, prior to incorporation, the company is not a juristic person and under common law not able to conclude contracts and also since the company is not in existence, no agent can act on its behalf. To resolve this issue, the CAMA provides that these types of agreements may in certain instances be binding on the project company.<sup>13</sup> For these reasons contracts like pre-development agreements may become binding on the SPV after it is incorporated.

#### **5. Relationship Agreements**

The first set of agreements entered into by the consortium members is necessitated by the need to put ‘their house’ in order before engaging with the public sector party. Therefore, the project promoters, which are usually a consortium, would typically enter into a number of agreements amongst one another, delineating responsibilities and apportioning risks and rewards amongst themselves. Some of these agreements are discussed below:

##### *Pre-development Agreement*

The private sector investors would need to conduct feasibility studies and other early development activities on the project prior to commencing project development. Infrastructure projects studies require significant investments and are sometimes very risky as investors may lose their early investment where studies reveal that the project is not feasible. It is for this reason that the parties would enter into a pre-development agreement to define their rights and obligations relative to the pre-development expenses. Sometimes these agreements are entered into even before the SPV is incorporated.

##### *Shareholders’ Agreements*

The shareholders’ agreement is typically two different agreements rolled into one. Firstly, it regulates the relationship between the project promoters and the SPV, which is in its self a separate legal entity from the promoters. Secondly, it also regulates the relationship between the members *inter se*. The shareholders’ agreement covers a number of issues like the business the company should go into, the way the company should be managed, the ownership and manner of transfer of shares and the protection of shareholders rights amongst others.

##### *Shareholders Support Agreement*

There are instances where shareholders enter into a support agreement with the SPV to perform certain actions or vote in certain way in the future in furtherance of the activities of the company. For instance, the shareholder might agree to vote in favour of the recapitalization of the SPV in the future and this becomes binding on all the shareholders that have entered into the agreement.

#### **6. Risk Management**

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<sup>12</sup> Companies and Allied Matters Act, 1990.

<sup>13</sup> See S.72 of CAMA which requires ratification by the company after its incorporation for such contracts to bind the company.

One of the important aspects of privately financed infrastructure transaction is the issue of risk management. It is the sharing of risks between the parties that creates Value for Money for the project. The general rule is that a particular risk is allocated to the party that is best able to manage the risk and subsequently mitigate the consequences of the risk. Risk is also important in valuing the project and the amount of financing required to deliver the project. Therefore, it is usually the case that an investor, who has been allocated a particular risk, prices the risk and charges a premium for assuming the risk. The nature and volume of risk that is allocated to the private sector investor in a project is determined by the mode of private finance transaction that is adopted. It is the general rule that privatizations involve the transfer of more risks to the investor than PPPs. Other finance models like joint ventures and contractor finance sit somewhere in between privatization and PPPs.

The basic instruments for the allocation and mitigation of risks are contractual clauses. Where lawyers engage in the negotiation of contractual clauses, what they do effectively is to negotiate the allocation, mitigation and pricing of risks. For instance, project related risks such as construction risks, cost overruns risk and demand risks are all allocated and adjusted through contract design. The contract may basically allocate risks through the use of indemnities, conditions, warranties and force majeure clauses. However, this may not be as straightforward as it seems from the outside. The project may suffer if parties are allocated risk which they are unable to handle or if they have not charged adequate premiums for assuming the particular risk. It is therefore widely acknowledged that the imperfect allocation of risk in contracts constitutes one of the primary reasons for the failure of privately financed projects.<sup>14</sup> Failure to allocate risks properly in such contracts may also lead to other undesirable consequences like contract re-negotiation or project collapse.<sup>15</sup>

The issue of risk management is therefore essential in privately financed infrastructure contracts for three main reasons viz; it improves risk allocation and reduces economic costs; it provides incentives for sound management of the project; and it reduces the need to enter a renegotiation process.<sup>16</sup> The contract should be drawn up in such a way so that it takes into consideration all eventualities that may affect the risk profile of the parties. Contracts that fail to address risk in a comprehensive manner are likely to raise the cost of infrastructure services to the final consumers.<sup>17</sup> When allocating risks in contractual documents, the following goals should be pursued:

- a) to provide incentives to reduce long term costs of a project;
- b) to provide incentives to complete the project on time and within budget;
- c) to provide incentives to improve the quality of service and revenue yield;
- d) to insure the public and private partners against risk. Risk insurance for the public partner helps to improve its profile of expenditure on the project by converting variable operation and capital cost into predictable unitary payments. Therefore, it helps the private partner reduce the cost of capital.<sup>18</sup>

These goals mentioned above can be achieved by contractually providing for the service output specifications of the private sector. This will fully ensure that risk for the quality of the service is transferred to the private sector by ensuring that the private sectors revenue has a correlation with the quality of its service. It also enables the public sector effectively monitor the output of the private

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<sup>14</sup>Murphy T. 'The Case for Public- Private Partnerships in Infrastructure', (2008) Vol.51, No.1 *Canadian Public Administration* pp. 99-126.; Berg M.R. 'Revisiting the strengths and limitations of regulatory contracts in Infrastructure Industries', PURC Working Paper No.14 , University of Florida, Glanville, Cited in Marques R. and Berg S. Risk, Contracts and Private Sector Participation in Infrastructure supra.

<sup>15</sup> Note that the renegotiation of a long term infrastructure contract is not necessarily always a bad thing. It may become desirable due to a change in the economic and social conditions under which the project was consummated.

<sup>16</sup> Asenova, D. (2010) 'Risk Management in Private Finance Initiative Projects: The role of Financial Services Providers', Lambert Academic Publishing: Saarbrucken.

<sup>17</sup> Marques R. and Berg S. Risks, Contracts and Private Sector Participation in Infrastructure Supra

<sup>18</sup> Iosa E. *etal* 'Best Practices on Contract Design in Public-Private Partnerships' Report Prepared for the World Bank, 2007

sector.<sup>19</sup> It is not uncommon for investors to request for guarantees or other similar instruments from the government, especially in developing economies, to manage risks that may arise out of the project. This is basically because the perception of project risks is higher in developing countries. The higher risk perception arises for instance from the greater likelihood of adverse political action by the governments of developing economies and the obvious fact that most developing countries have fragile economies, with citizens having weaker purchasing power than citizens of developed countries.<sup>20</sup> These sovereign guarantees are in some cases further backstopped with additional financial instruments like letters of credits or where they are provided by a multilateral agency like the World Bank, the threat of exclusion of the country from future financial loans or grants.

## 7. Principal Project Agreements

Upon commercial close, the SPV negotiates and enters into a number of agreements in order to facilitate financial close and to begin the construction phase of the project. The distinction between commercial close and financial close is rather slim. While the former refers to the point where the parties have agreed on all the commercial aspects of the transaction, the latter refers to the point when all the terms relating to the project have been agreed upon and financing secured for the project. In practice, it is not unusual for both of these to occur at the same time. Below are some of the principal project agreements:

### *Grant/ Concession Agreements*

The Grant or Concession Agreement is the principal contractual document delineating the rights and obligations of the parties in a privately financed infrastructure transaction. A concession agreement grants a right (usually exclusive), which hitherto belonged to the public sector, to a private sector partner to operate and manage an asset for certain duration of time. Usually, and particularly in greenfield assets, this right is coupled with a right to invest in the construction of the asset. The Concession Agreement sometimes requires the private sector grantee makes either upfront fixed payments or periodic term payments to the grantor.<sup>21</sup> The making of this payment is significant not just because it generates revenue for government but also because it evidences the fact that the ownership of the asset remains with the grantor.

Typically, the concession agreement will be drawn up in a manner that allows the private sector recover its investment and make reasonable returns from the exploitation of the grant.<sup>22</sup> The revenue of the private sector may accrue from periodic availability payments made by the granting authority to the concessionaire or from the direct collection of user fees from the public for services rendered. The concession agreement contains some key terms, which are unique to these types of agreements. The most important of these clauses is ‘the Grant’. This is the operative clause in the agreement and conveys the right or interest in the asset from the public authority to the private sector. Another is the ‘Concession Term’ which defines the length of the interests of the private sector in the concession. The ‘Payment Terms’ stipulates the amount and method of payment of the concession fee by the private sector. The ‘Operations and Maintenance’ clause grants the private sector concessionaire with authority to operate and maintain the asset conveyed. The concession agreement will also usually contain an obligation on the private sector concessionaire to transfer the property back to the government at the end of the concession term. Finally, the Agreement may also give the public authority power to

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<sup>19</sup> Ibid.

<sup>20</sup> See for instance, Sachs Tillman *et al.* ‘Analysis of Political Risks and Opportunities in Public-Private Partnership (PPP) in China and Selected Asian Countries: Survey Results’ Chinese Management Studies, Vol.1 Issue: 2 pp. 126-148. Also, according to OECD the region benefitting most from guarantees was Africa, followed by Asia and Eastern Europe, which are all developing countries. See Raundi Halvorson-Quevedo and Mariana Mirabile ‘External Financing for Development’ March 2014 found online at: <http://www.oecd.org/dac/stats/guaranteesfordevelopment.htm>, Last accessed on 7<sup>th</sup> September, 2018.

<sup>21</sup> In some cases, the public sector authority instead makes availability payments to the concessionaire.

<sup>22</sup> See for example S, of the ICRC Act

periodically inspect and monitor the concession to ensure that the concessionaire is meeting its obligations regarding to the maintenance and operation of the asset.<sup>23</sup>

#### *Construction Agreements*

Where the concession involves the construction of a greenfield asset or the rehabilitation of an existing one, the SPV would need to negotiate and enter into a concession agreement with a construction company or contractor. The major objective of this contract is to ensure that the contractor delivers the asset in accordance with the specifications of the SPV. The specifications would amongst other things, be in accordance with specified quality and time. To ensure that the entire construction process is delivered in an efficient manner, within time and cost, the most common construction contract awarded by the project company is the type that bundles together the Engineering, Procurement and Construction aspects of the project and commonly referred to as 'EPC' contract. The advantage of the EPC contract is that it saves time and money as it allows the three aspects of the project to move concurrently on a turnkey basis.

The payment structure of the EPC contractor may be restructured in various ways. For instance, it may be designed as a Fixed Price Contract, which allows the SPV to pay a fixed fee to the contractor for its services. This is particularly helpful where the project company is worried about inflation or currency exchange risks and wishes to transfer these risks to the contractor. For assuming these risks, the contractor would typically charge a risk premium to enable it manage whatever contingency that is likely to arise. However, there are certain instances where the contractors risk premium will not suffice, especially where the fault for the occurrence of the risk is not that of the contractor. In these cases, the contractor protects itself by negotiating a contingency payment to manage the uncertainties. The alternative payment arrangement is the 'Cost plus Fee Contract', which ensures that the SPV assumes the cost of construction and only pays the contractor a fee for its services. This arrangement effectively leaves all risks capable of increasing construction costs with the SPV.

Whatever payment model is chosen, the major aim is to ensure that the contractor is efficient in delivering the project on time and within cost. Therefore, an incentive may be built into the contract rewarding the contractor where it meets targets and a penalty where it exceeds budget. The important thing for the SPV is to ensure that it passes whatever construction risk that exists in the concession agreement to the EPC contractor through the construction contract. Construction contracts will typically contain a number of key terms: This includes the scope of work, contractor and project company's responsibilities, the payment terms and conditions of subcontracts.<sup>24</sup>

#### *Operations and Maintenance Agreements*

After the private sector company completes the construction of the project, it will then have to operate and maintain the facility for the remainder of the concession term. The SPV is faced with two options: to either operate the facility itself or to subcontract this aspect to other specialist companies. It will be recalled that the project company is usually a consortium of different companies with different capabilities. Therefore, self-operation of the asset is possible where one of the consortium members has experience in operating the type of facility, in which case the responsibility for operation and maintenance is assigned to that entity, provided that its prices are competitive. Nevertheless, regardless of whether the consortium is self-operating or subcontracting, the SPV normally enters into an operation and maintenance (O&M) agreement either with the subcontractor or with its consortium member that is charged with the responsibility.

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<sup>23</sup> Nwangwu George 'Public Private Partnerships in Nigeria: Managing Risks and Identifying Opportunities' Palgrave Macmillian, London. pp. 67-68

<sup>24</sup> See Nwangwu Supra

When negotiating the O&M agreement, the lawyer representing the SPV must identify and mitigate some of the likely risks that may emanate during the operational phase of the project. Two of the most obvious of these risks are the possibility that the operator may not perform according to contract (due to inexperience or negligence) or that operating and maintenance costs may exceed budgets. The risk of non-performance may be managed by making sure that there is a competitive bidding process that ensures that only the best qualified and experienced companies are selected to handle the O &M on behalf of the SPV. Furthermore, the selected company may be required to post performance bonds or other guarantees, which secures the right of the project company to liquidated damages in the event of non performance.

#### *Off taker Agreements*

The off-taker agreement is used to manage demand risk in the project. Investors would like to assure themselves that there is a ready market for the product or services, which is the output of the concession. The reason for this is that the cash flow and profits of the business depends on the demand for the services, especially under a user fee payment arrangement. Due to the fact that the transaction is funded under a non-recourse or limited recourse arrangement, financiers rely on the assurances of the availability of an off taker in funding the project. There are different ways through which investors ascertain certainty of off take: One of which is by requesting for a purchase guarantee from the government or otherwise the project company will enter into forward agreements with potential purchasers of the project offerings. These potential purchasers are the ones referred to as off takers, guaranteeing the purchase of the products or services. A good example of an off-take agreement is the Power Purchase Agreement in electricity sales, where the government or another entity buying electricity enters into an agreement with a power utility to purchase power from the utility at a particular price and under certain terms during the term of the Agreement. Where there is uncertainty of offtake, the private sector party may demand offtake or minimum revenue guarantees from the government as a condition for going into the transaction.

### **8. Financing Agreements**

There are a number of agreements that are entered into between the project sponsors or the grantor and the project lender at financial close. This section looks at some of these agreements/

#### *The Term Sheet*

Most debt financing commitments from the project lenders would commence from the issuance of a term sheet to the project promoters. The term sheet basically outlines the commitment of the lender to the borrower. The legal effect of a term sheet depends on its wordings. Where it is worded as a mere letter of intent as opposed to a firm commitment from the lenders, then it probably has very minimal legal value. Where the term sheet has gone through the lenders credit committee, its wordings are likely to be more committal and may therefore amount to a firm offer from the lender to the borrower. The term sheet will contain terms like the loan amount, interest rate and duration, including any moratorium if applicable. It would also outline the proposed use of proceeds and any condition precedent to drawdown.

#### *Loan Agreements:*

The loan agreement is the primary financing agreement. It details and regulates the relationship between the sponsor borrower and the lenders. The loan agreement typically expands on the provisions in the term sheet and is definitely binding between the parties unlike the term sheet which is susceptible to different legal constructions. The loan agreement also supersedes all previous agreements in respect to the funding of the project previously entered between the parties. In addition to the other provisions that are contained in the term sheet, the loan agreement will contain detailed representations and warranties and other similar covenants between the parties.



*Intercreditor Agreements:*

Large privately financed projects are expensive and risky and therefore usually financed via syndicated loan arrangements with multiple debt providers. Where there are different lenders to a project, they will normally enter into an intercreditor agreement to document their various interests, rights and obligations against one another. One of the important issues which an intercreditor agreement deals with is the priority of lenders in repayment and their various lien positions *vis a vis* one another.

*Direct Agreements:*

The project agreements do not create privity of contract between the lenders and the grantor or even a legal relationship between the lenders and the financed asset. Therefore, it is important that lenders have a pathway to recover their loans in the event that the private sector operator of the asset is in default of its loan obligation and becomes unlikely to fulfil its obligation to repay the loan. For this reason, a direct agreement is entered into between the lenders and the government, granting the lenders step in rights in the event that the private sector becomes unlikely to fulfill its obligation to repay the loans. These rights would allow the banks or other financial institution to take over the asset and recover their investments in the event of default from their private sector borrowers.

*Credit Enhancement Agreements:*

Credit enhancement agreements are needed in privately financed infrastructure projects for two reasons: The first is that these types of projects are too risky and therefore lenders are likely to price in the cost of this risk in determining their cost of funds, therefore making the projects very expensive. The second reason is that it is usually more expensive for private sector investors to borrow than the government, therefore potentially making the project more expensive than it would have been if funded directly by the government. To make privately funded infrastructure projects cheaper, lenders therefore require some form of additional support to make these projects bankable, by effectively substituting the credit risk of the private sector party with that of the sovereign. Credit enhancing agreements in the main, help mitigate credit default risks and enhance the credit worthiness of the privately financed projects.

*Export Credit Agreements:*

Sometimes project sponsors might seek financing from Export Credit Agencies (ECA) and therefore enter into Export Credit Agreements. The nature of the financial support from these agencies to the project include direct lending which is usually conditional upon the purchase of equipment from the country of origin of the ECA. The other is the financial intermediary loan where the ECA grants loans to a domestic commercial bank for un-lending to the project sponsor. There is also the interest rate equalization which allows a commercial bank to receive the difference between the market rate and its lending rate to the project sponsor from the ECA.

## **9. Termination/ Handover**

Privately infrastructure contracts like any other contracts have a terminal date or the parties may wish to bring it to an end before its due date. However, the termination of these contracts is treated differently from the regular contracts. The reason for this is that long term infrastructure contracts usually involve the delivery of essential services to citizens and their termination would normally have adverse societal and economic consequences, if not properly managed. The second reason is that these contracts usually involve the construction of 'sunk' assets with unamortized costs in the short and medium terms. If they come to a sudden end, the fact that the private sector investor would most likely not have recouped its investment therefore needs to be taken into consideration during termination. This means that if equity must be done between the contracting parties, then the private sector investor should be compensated for the assets that it can't physically take away or of which it has not earned agreed returns from when the contract comes to a sudden end.

Termination payments under privately financed infrastructure agreements are very similar to liquidated damages provisions in any regular contract.<sup>25</sup> However, while liquidated damages provisions are considered as genuine pre-estimates of the loss which the parties to the contract are likely to suffer as a consequence of the contract coming to a premature end, they are not absolute and may yet be classified as penalties.<sup>26</sup> There are also certain losses that are not recoverable as damages under general contract law.<sup>27</sup> What is allowable as liquidated damages may be further curtailed by the principles of mitigation and remoteness of damages and also contributory negligence.<sup>28</sup> Termination payments under long term infrastructure contracts are not necessarily limited to anticipated losses. Indeed, in assessing termination payments, parties may agree to include other extraneous factors that are not normally taken into consideration in assessing damages like the unamortized value of the assets, the unrepaid portion of debt and equity and other public policy considerations.

In summary, there are no particular sets of rules which regulate termination payments in long term infrastructure contracts. However, common sense dictates that termination payment provisions on the part of the private sector investor must be fair, provide an incentive to investors to invest and also satisfy lenders, otherwise the project might not be bankable. Conversely, for the public sector, termination payments must not be structured in such a way that makes it more favourable to pursue termination rather than continue with the contract.<sup>29</sup> It is important to note that termination payments may also serve as a reference for determining the value of the concession. In other words, the amount of termination payment that a concessionaire is likely to get at each particular point in time in the lifespan of the contract may be a signpost as to the true value of the concession at that particular time.<sup>30</sup>

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<sup>25</sup> For exposition of the principles around liquidated damages See the case of *Dunlop Pneumatic Tyre Co. Ltd v New Garage Motor Co. Ltd* [1915] AC 79, 87-88

<sup>26</sup> See the case of *Pneumatic Tyre Co. Ltd v New Garage Motor Co. Ltd* *ibid*

<sup>27</sup> *Hadley v Baxendale* [1854] All ER Rep 461.

<sup>28</sup> See Otedola O., 'Penalties and Liquidated Damages in a Changing World: Rethinking the Common Law Position' (2015) *Journal of Sustainable Law and Policy* 6(1) 247- 271.

<sup>29</sup> This may also be for the benefit of the private sector as the public sector should not also be incentivised to pursue termination of the contract instead of executing the project.

<sup>30</sup> This is particularly important to accountants when valuing the company.