GETTING STARTED – EVALUATING A PORT PROJECT INVESTMENT

In this first of three articles focused on port sector investments, Watson Farley & Williams LLP, details the most important initial considerations

The ownership, acquisition and development of ports and terminals requires significant financial investment. The private sector (both existing trade operators and financial/infrastructure fund investors) is playing an increasingly important role in port projects; it is important both as a source of finance and as the provider of some, and in some cases, all of the services required for the successful operation of a port.

The Watson Farley & Williams LLP, Terminals & Ports Group, takes a look at some of the main points to consider when first evaluating a port project investment.

■ Christina Howard

JOINT VENTURES

Joint ventures provide an opportunity for partners to combine their resources and expertise and share the cost of an investment, but the structure will vary according to the jurisdiction and the specific nature of the port project. If a port project investment is structured by way of a joint venture, it is common for the partners to establish a local special purpose vehicle (SPV), in which each partner is a shareholder, with the SPV as the concession holder.

DUE DILIGENCE

A key issue for any investor will be the due diligence to be undertaken to underpin their investment into a port project.

There is no 'one size fits all' approach to due diligence but for investments which are subject to English law, the investor is subject to the principle of 'caveat emptor' (buyer beware). This means that the investor should carry out an investigation of the port project to identify any adverse factors potentially affecting the project and/or the investor's long-term investment strategy.

MATERIAL CONTRACTS

In carrying out a due diligence review in relation to a port project, there are many issues which need to be considered. Importantly, the investor should verify the existence of any material contracts which may either favourably or adversely affect the project and/or the concession holder, and which may affect the investor's projected return from the investment.

The main contract in any port project is the concession agreement. In addition to the points highlighted below, it is essential to verify that the relevant local law requirements have been complied with in granting the concession and there is no risk that the concession could be terminated or revoked due to non-compliance with such requirements.

Other 'material' contracts for a port project are likely to include terminal use agreements, key customer agreements and construction/operational agreements, as well as real property leases, leases for important plant or equipment, existing joint venture agreements (if any) and, if the project is already financed, loan agreements and other finance/security documents.

The main provisions to check in a material contract include:

- **Change of control clauses:** commercial agreements may prohibit a change of control in respect of the concession holder or alternatively trigger termination rights, require prior consents or impose other duties related to the change of control, such as payments or requirements for extended notice periods;
- **Assignment or novation clauses:** verify whether the consent of a third party (for example, a financial institution, government body or shareholder) is required in order for any transfer to be valid;
- **Payments:** confirm the tariff structure and payment terms under the services agreements, as well as royalty payments due under concessions to grantors and income streams under any terminal services/usage agreements; and
- **Termination:** consider the duration, expiry, extension and events of default, as well as other termination rights, any compensation payments due on termination and the rights of the concession holder to terminate the contracts.

EXTERNAL FINANCING/BANKABILITY

It is common for funding for a port project to be sought by way of external financing through a commercial loan from a bank or development fund or subscription for bonds. The financing may already be in place at the time of investment, or it may be sought post-investment.

If the external financing is in place pre-investment, the investor will need to review the finance arrangements as part of its wider due diligence review. If external financing will be sought after the investment, any company assessing a potential port project will also need to ensure that the project

is 'bankable' to avoid future issues when approaching financiers as often existing finance agreements cannot be renegotiated. Local law advice should be obtained in relation to any specific local security or tax issues.

Concerns that will guide a review of external financing arrangements include:

- **Certainty and control:** around the key contracts, including, in particular, the concession agreement - for example, verify whether the concession agreement contains any rights in favour of the port authority to withdraw or condition any permits or licences, or for a counterparty to terminate the concession;
- **Clear risk allocation and protection:** in the key contracts, including, for example, exclusivity, liquidated damages, termination and termination compensation;
- **Change of control/consents:** if any transaction will result in a change of ownership (direct or indirect) of the concession holder, confirm whether such change will trigger a change of control under the concession agreement/existing finance arrangements. Breach of any change of control provisions may result in a right for the port authority to terminate and revoke the concession or trigger a lengthy consent process or require repayment of the loan;
- **Onerous financial provisions:** under the terms of the concession which may impact the concession holder's ability to service the loan, for example, if the concession holder is subject to significant compensation requirements or penalties in the event of non-performance or breach;
- **Security:** the ability to take security over the concession holder, as well as its assets and key contracts; and
- **Payment obligations:** the ability of the concession holder to satisfy its payment obligations and repay the loan.

REGULATORY AND TAX FACTORS

As with the other factors outlined above, regulatory and tax factors will depend on the specific port project, and local law advice should always be obtained. Timely and thorough due diligence should assist in identifying any concerns and/or issues.

■ **Richard Stephens**

■ **Hayley Arrow**

Key considerations include:

- Rights, licences and permits: ensure that the concession holder holds all the rights that it requires for the operation of the port project, including all necessary permits and licences;
- Employees: check the terms of any collective bargaining agreement(s), employee benefit plans (including pension plans) and/or any requirements under local employment law which may affect the stability of the workplace as well as the profitability of the investment;
- EU/competition: at the start of planning the project, conduct a full analysis of possible competition issues to determine (a) the possibility, availability and lawfulness of State Aid for investment in the port or other purposes; (b) whether the project structure needs to be pre-cleared under EU or national merger control rules; (c) whether any collaboration between actual or potential competitors would be permissible; and (d) whether any commercial arrangements for future use of port infrastructure or allocation of capacity will be regulated;
- Procurement: verify that the relevant local law requirements have been complied with in granting the concession and there is no risk that the concession could be terminated or revoked;
- Environmental: depending on the location and nature of the port project, analyse the local environmental laws and regulations and potential liabilities for the concession holder. The consequences of environmental liabilities can be very serious and if any such liabilities are identified during the due diligence process, appropriate indemnities should be included in the investment documentation; and
- Tax: consider local corporate taxes, and any available tax reliefs, together with the tax impact of financing structures, such as local withholding taxes on cross border dividend or interest payments.

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