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African brownfield projects: private equity funds saddled with approval procedures

It is a known fact that the major private equity funds employ a diversified sectoral approach to investment. Target sectors in Africa have broadened from the traditional energy and infrastructure sectors to now include financial services, telecommunications, real estate and, more recently, consumer goods.

When a project involves (i) an exiting industrial player; (ii) a "sensitive" sector; and (iii) an unamortized project debt in the company holding the asset, a lengthy preapproval process is to be expected.

In our most recent energy sector major transactions, the list of intermediaries from whom prior consent is required by law, contract or custom is considerable and includes: the host state, the national electric utility, development financing institutions (DFIs) and issuers of guarantees against the default risks of the public counterparty.

The Host Country Approach

Typically, electric generation project documentation includes (i) a concession contract with the host state, and/or (ii) a power purchase agreement ("PPA") with the host state and/or the national electric utility. Moreover, in the event the project is subject to both a concession contract and a PPA, the State often provides a sovereign guarantee as additional comfort or acts as co-debtor of the obligations of the national electric utility under the PPA.

Depending on the level of sophistication of such documentation, these contracts will usually include a prohibition on assignment without the consent of the non-assigning party (e.g., the utility or other State entity). However, in our experience, these contracts often fail to address the issue of change of control, thereby raising the possibility of a sale of shares at a corporate level higher without project contract counterparty consent.

Nonetheless, notification to the State of any change in control of the project company is recommended, regardless of whether required by the project documents and/or the guarantee documents. To fail to do so puts at risk the open dialogue with public authorities that is so critical to project success. This can be particularly important where a private equity fund becomes a majority shareholder in the project, replacing an industrial company whose line of work and intentions are far more familiar to the authorities.

Consent of Banks

The consent of banks is another material condition precedent to the implementation of the contemplated transaction. Notice and consent obligations will be clearly outlined in loan documentation and change of control via share transfer is often expressly addressed in share retention deeds, hence avoiding the issues noted above. Unless expressly authorized, not only is control at any level non-transferable, but banks regularly require the ultimate shareholder(s), whether legal or natural persons, to keep some economic ownership interests in the project company at levels to be negotiated with lenders. It is often the case that such share retention may be structured for "flexibility" with different tiers of required retained ownership depending on current ant prior financial, technical, environmental and other performance ratios of the underlying project. When the assets concerned comprise gas, fuel or coal fired power stations and are financed with loans by DFIs, such performance ratios will be more restrictive and subject to higher standards of review.

Here again, a plan of early approach to the lenders must be considered and prepared. In addition to allowing for the time requirements of the lenders' own approval process, latent default under the financing documentation often come to light during the audit phase. Curing these defaults through the implementation of corrective measures adds substantial time to the process and depending on the circumstances underlying the defaults, may result in even more contractual performance ratios under the loan documentation. Time and attention will also need to be given to respecting and incorporating certain evolving set of rules imposed by – as applicable – the DFIs, the United Nations, the European Union (list of individuals and entities sanctioned, origin of funds, money laundering, corruption, fraudulent or anticompetitive practices, etc.).

The success of this crucial and time-consuming stage depends on the buyer's degree of preparation, and the accuracy of the due diligence carried out on the legal, financial and technical audit procedure.

Of course, the banks' consent, as a condition precedent to the closing of the transaction, is itself conditioned upon the updating of all bank (including security package) and project documentation, by way of novation, assignment or amendment.

Protection Against Default Risk

A key (and arguably the most challenging) element of the legal structuring of a power project in Africa financed by DFIs is the guaranteeing against default by the national electric utility (and/or, as the case may be, the failure of the State in its capacity of guarantor) of its obligation to timely pay invoices issued under the PPA (including those "capacity payments" for electricity that could have been produced but was not, due to a risk attributable (or attributed) to the local counterparty).

The International Development Association (IDA), an entity under the auspices of the World Bank based in Washington D.C., offers guarantee mechanisms that appear to be consistently favored by lenders to address this issue. The IDA mechanism is notably complex (and not all projects are eligible) because it presumes the signing of numerous bilateral or multilateral agreements among the IDA, the host state, the national electric utility and the project company. Nevertheless, if available, this mechanism allows for an IDA guarantee of repayment of the equity and/or debt in return for a settlement agreement between the IDA and the host state. In order to qualify for this guarantee, the host state must be the originator of the request for guarantee and the ultimate risk bearer.

In its agreement with the project company, the IDA imposes additional positive and negative covenants similar to those in the financing documentation discussed above. Among these (and for the same reasons) is the obligation to notify of any changes in the shareholder structure of the project company.

Due to the very unique nature of the relationship between the World Bank institutions and each host state, as well as the risk incurred by the latter as a consequence of enlisting the support of the IDA in connection with certain projects, the continuation of such a guarantee post-change of control can be more easily secured pursuant to a careful and prepared approach of the concerned State entities.

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