M&A KEYNOTES

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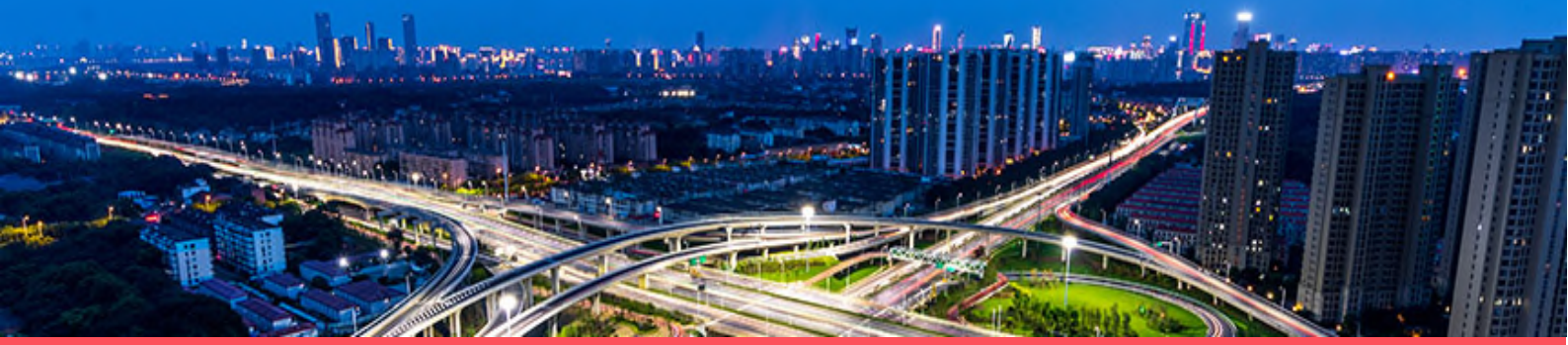
Infrastructure M&A: Key Issues



An overview of Infrastructure M&A

The key themes and identifying features of M&A transactions involving infrastructure assets, as compared to other M&A transactions, are that they:

- are transactions with a **long-term effect** given the long-life span of the underlying Infrastructure asset;
- involve **high costs** due to the inherent size and scope of infrastructure projects (as well as committed ongoing maintenance requirements of the underlying Infrastructure asset);
- have a **material environmental impact**, given the interaction between, on the one hand, land, sea, air, people and flora/fauna and, on the other, the Infrastructure asset(s); and
- given the competition for Infrastructure assets, are **often sold as part of an auction process**. This means that the sale process and timeline is dictated by the seller and its advisors. See also "M&A KeyNotes - Auction Sales".

Infrastructure M&A spans across various industries, including oil & gas, power, including renewables, transport, waste planning, telecommunications and social infrastructure. Given its identifying features, Infrastructure M&A tends to attract sophisticated, cash-rich investors looking for long term and reasonably stable and predictable cash flows, notably pension funds, insurers, sovereign wealth funds and infrastructure funds, who invest in the Infrastructure project, alongside the developers or operators who provide the necessary know-how and are often responsible for the running of the project.

Hot topic: debt financing

Another feature of Infrastructure M&A is that it is usually expected that the underlying Infrastructure project generates steady revenue. As a result, Infrastructure M&A attracts a range of debt financing options not otherwise available on other M&A transactions, such as project loans, bond financing and securitisations. These arrangements may already be in place. Debt financing in the context of Infrastructure M&A is not discussed in this KeyNote, but it is important to note that the negotiation of, or impact on, debt financing arrangements is considered in parallel with the M&A process.

Key transaction documents on an Infrastructure M&A transaction

1 Shareholders' agreement

The shareholders' agreement is a key document in the context of Infrastructure M&A. It governs the relationship between the parties funding and investing in the project. As noted above, Infrastructure M&A typically combines financial investors and technical operators and their relationship, notably allocation of responsibility and funding obligations, presents several challenges which need to be addressed. Some of the key provisions included in the shareholders' agreement relate to:

Change of control and transfer restrictions: as mentioned above, Infrastructure transactions are long-term projects and the parties are, therefore, entering into long-term commitments to each other. A great emphasis is also placed on ensuring robust change of control and transfer restrictions are drafted to prevent investors and operators from exiting the investment early or transferring it to unsuitable third parties.

Given the differing roles of investors and operators, the transfer restrictions for operators will ordinarily be more stringent. The investors rely on the expertise and day-to-day management of the project by the operator and, accordingly, will want to have control over any proposed transfer by an operator to ensure continued operation of the project, particularly in light of the fact that there are very few operators who will have the required technical capabilities. Operators will also negotiate transfer restrictions of investors, to ensure that any financial commitments will be adhered to.

Furthermore, some of the key investors in Infrastructure M&A have regulatory and other restrictions in relation to other parties they can or can't do business with. Each party will want to ensure that the financial soundness of any new 'controller' is at least of the same standing as the original party.

Transfer mechanics (such as options) may be built in to enable a way forward or as a means of incentivising agreement in the event of an irreconcilable deadlock due to no fault of a party.

Exit mechanics: the exit provisions where a party is in default of its obligations in relation to the project need to be carefully drafted. Each party will want to ensure it has a practical recourse against the other in a default scenario, including the ability to force a buyout. The parameters around any such buyout must be carefully considered and drafted, including the price attributable.

In an exit scenario, consideration also needs to be given to the break costs of debt, whether the project can be successfully run without the defaulting party, whether the project can be funded in the event of an exit by a partner and tail obligations, such as, decommissioning obligations.

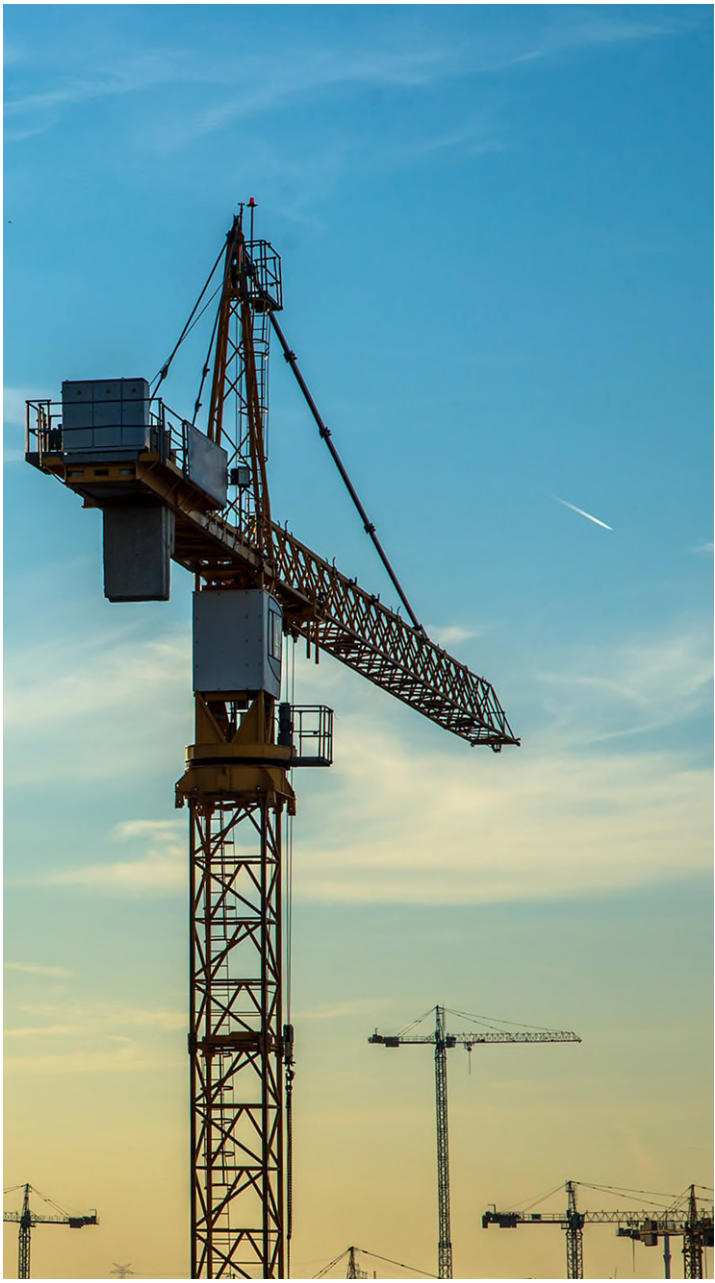
Equally, given the high costs of the transaction, standard M&A buy-out provisions in the case of a default by one party may not be useful, if the non-defaulting party doesn't have the funds to pursue such a route or if a replacement is not readily available. In those circumstances, it may be appropriate to suspend the defaulting party's rights in relation to the project until the default has been satisfactorily remedied, including profit distributions or voting rights. The non-defaulting party will, however, want to ensure that the defaulting party is obliged to continue to perform its obligations during any such period.

Dividend policy: financial investors are keen to ensure that the shareholders' agreement clearly sets out the basis on which distributions will be made to shareholders, particularly given the interaction with the long-term debt issued in relation to the project whereby repayment of such debt will rank in priority to any profit distributions (see also "Hot topic: debt financing" above).

Decision making: another key feature of Infrastructure M&A is that investors will have different expertise, for example an operator will be much closer to the project than a financial investor. Accordingly, the majority of day-to-day decisions will be made by the operator to ensure that the project is ran efficiently.

Nevertheless, financial investors will want to reserve certain matters that require their involvement and consent and these should be carefully considered from the outset. A balance needs to be struck between allowing projects to proceed efficiently and giving investors the right amount of oversight and authority.

Conversely, while certain matters will be reserved to financial investors, operators will be keen to ensure that they have authority to take certain decisions in emergency situations, which given the nature of the underlying project, need to be taken quickly and, therefore, often without an ability to involve all financial investors.



The shareholders' agreement may also govern the decision-making process in relation to funding obligations and the provision of parent company guarantees if these are likely to be relevant, e.g. "in construction" assets. Given the long-term relationships, the shareholders' agreement should be clear in the party's obligations where there is a need for capital to be injected. This will vary on each transaction and will depend on the various parties' commercial appetite in relation to the project.

It is often the case that operators will enter into related party transactions due to their knowledge of the relevant industry and the shareholders' agreement should govern how decisions to enter into such arrangements and any arising conflicts should be managed. Careful consideration needs to be given as to whether it is in the best interests of a financial investor for an operator to have an ability to sub-contract with related parties, if similar services can be obtained at better rates from third parties.

Given the disparity between an operator and financial investor's industry knowledge, it is important that the shareholders' agreement grants certain information rights to the financial investor to avoid a risk of exploitation. The practicalities of this should be considered, for example, a financial investor will not be able to access an oil rig, unlike in the context of other M&A transactions, where the issue is easily dealt with through the granting of board representation/observer rights.

Funding: if there are funding obligations on the parties, what these are and how they are fulfilled should be clearly set out, particularly in the context of projects in construction. These provisions should cover:

- the criteria and parameters for such funding (i.e. when it can be requested – this could be for construction or specified matters afterwards, such as decommissioning); and
- how the funding is provided (e.g. ordinary share equity, shareholder loans or other).

You will often find a requirement that these obligations are backed by credit support (parent company guarantee, bank letter of credit or other) which must be maintained on an ongoing basis.

2 Share purchase agreement ("SPA")

The SPA governs the actual acquisition of the target entity underpinning the Infrastructure asset and some of the key provisions included are:

Acquisition finance: the interplay with any acquisition finance documents, including the satisfaction of conditions precedent, should be carefully considered to ensure that the transaction works mechanically and to ensure all obligations under the various documents are clear. The parties will also want to ensure there is a certainty of funds, for example, through equity commitment letters, which should tie in with the SPA. See also "Hot topic: debt financing" above.

Material adverse change ("MAC"): given the unpredictable nature of an Infrastructure asset, the purchaser will want to ensure that MAC clauses are included to allow them to walk away from a transaction should something happen to the asset before completion. These are hotly negotiated and provide the purchaser with a level of comfort given the high-value nature of Infrastructure transactions. However, sellers will push back on the inclusion of MAC clauses (or attempt to narrow down their applicability). The purchaser will need to bear in mind that competition for the purchase of Infrastructure assets is fierce and, therefore, negotiation power may side with the seller.

Special warranties: as discussed in the "Key due diligence issues arising on an Infrastructure M&A transaction" section below, due to the nature of the underlying asset, the warranties given by the seller to the purchaser are often specialised and need careful consideration from the relevant specialists.

Gap control: see above commentary regarding reserved matters. The same considerations around decision-making impact value of the asset/interest and so are relevant here.

Governing law: depending on the jurisdiction in which the Infrastructure asset is based, careful consideration should be given to any licensing requirements to ensure the correct governing law is applied, for example, enforceability of a transfer of interests in projects in some jurisdictions may require local law to be applied to the documents; structuring may be needed if English law is important for certain obligations.

Deposit: depending on the nature of the underlying asset, the purchaser may be required to pay a deposit on exchange of the SPA – this is common, for example, in the oil and gas sector.

Hot topic: other agreements

In addition to the usual M&A-related documents, Infrastructure projects also include commercial agreements related to the project which will either be negotiated as part of the transaction or diligence as part of the acquisition. Understanding these key agreements and any related risks forms a key element of any due diligence. The key acquisition documents will need to reference these, such that decision-making in respect of them between the shareholders is clearly set out.

There will often be construction contracts entered into in respect of the development of the Infrastructure asset, which deal with risk allocation, project management, use of sub-contractors, delays, liquidated damages, performance and structural warranties and rights of inspection.

Similarly, operational/maintenance contracts will be put in place which govern risk allocation, consents and governance, fees, audit rights, service standards and mechanics for tendering/renewing contracts, in the context of maintaining an Infrastructure asset.

Moreover, commercial agreements will be negotiated by the parties, which govern the revenue generated by the Infrastructure asset. Depending on the nature of the underlying asset, these may take the form of offtake agreements, power purchase agreements or general commercial agreements.

Key due diligence issues arising on an Infrastructure M&A transaction

Below is a summary of issues which may require specialist input during the course of a due diligence exercise as part of Infrastructure M&A:

Environmental, social and corporate governance: Due to the nature of Infrastructure projects, a key concern for investors will be how the target manages its ESG strategy, in particular, in relation to the environmental impact such projects have. For example, the due diligence exercise will focus on the target's decommissioning arrangements and its management of carbon emissions. A huge emphasis is placed by investors on ensuring they are operating in an ESG-friendly manner and, therefore, this is an area of particular focus on an Infrastructure M&A project.

A key market trend is the increasing focus on sustainability statements, climate disclosures and ESG policies of asset managers and investors, who are keen to ensure that renewable projects meet their own criteria for investment in accordance with those policies. Furthermore, many renewable projects are underpinned by government support, so such continuing beneficial treatment/support will need to be verified in diligence.

Regulatory approvals and licenses: the technical nature of Infrastructure deals means that potential purchasers will want to diligence the approvals and licences required for the running of the project. Other considerations include:

National Security and Investment Act 2021 (and similar legislation in other jurisdictions): due to the cross-border nature of Infrastructure transactions, there is likely to be a lot of scrutiny into foreign investment.

PSC/Royalties: often investors will be enter into profit sharing arrangements, as part of governmental policies to encourage investment into infrastructure and these require careful diligence.

Material contracts: see "Other agreements" above for examples of the kinds of agreement that could be material from a diligence perspective, depending on the type of asset.

Real estate: due to the nature of an Infrastructure transaction, there are often title issues which need to be carefully considered. For example, in some bespoke cases like offshore wind, crossing arrangements need to be reviewed, to ensure that the project will have the correct permissions in place and doesn't interfere with other existing projects or the environment. For onshore sites, careful examination of any applicable restrictive covenants relating to the land is required and similarly, a purchaser will want to ensure it has attained any relevant rights of access.

Intellectual Property: for technology-focussed deals, where the underlying technology is a big part of the Infrastructure asset, investors will be keen to ensure that there are relevant intellectual property protections in place to safeguard its investment.

Tax: certain sectors within the Infrastructure landscape have standalone taxation regimes, for example, petrol or minerals. These should be carefully considered at the due diligence stage so that investors fully understand their tax position and do not end up with unforeseen tax liabilities.

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