Effective design and delivery of Megaproject through Special Purpose Entities/Special Purpose Vehicles (SPEs/ SPVs)

Tristano Sainati
t.sainati@leeds.ac.uk
Why this matter?

- SPVs are widely employed in infrastructure projects:
  - Project finance: always
  - Public Private Partnership: often/ sometimes
  - Private Finance Initiative: always
  - Joint ventures: often (incorporated joint venture: always)

- SPVs enable complex/structured transactions that are rarely understood by non-experts.

- Concerning the governance of SPVs, much of the knowledge is implicit (experienced lawyers). This research attempt to make explicit some design and decision-making principles.

- The research explains how SPVs influence the governance of infrastructure megaprojects - Focus on the formal governance (contracting) and its implications on the governance/management
Megaproject COST Action

- Megaproject was a temporary network of European researchers
- Supported by the COST Action Grant scheme
- Undertaking research around a specific topic: megaprojects and their performance in Europe
- Multiple case studies

http://www.mega-project.eu/
The use of SPVs is statistically correlated with the megaproject performance

My PhD studied how SPVs influence the governance of megaprojects
What are SPVs?
Very different understandings

What is a Special Purpose Vehicle?

Intentionally an Off-Balance Sheet Instrument

Legal Domain

Megaproject sub-Domain

(Infrastructure Related Activities design & delivering, operating, other services). Mostly Project Financing and Public-Private Partnership

Project Management sub-Domain

Financial Domain

Management Domain

Financial Vehicles supporting structured financial transactions

[Image of a situation where different understandings of SPVs overlap with various domains such as legal, management, and financial.]
What is a SPV? Defining features

- Legal personality
- Limited and pre-defined purposes
- Fenced entity

- Incorporated companies
- Limitation imposed by contractual provisions
- Additional constrains introduced by the article of association
- Articulated ownership structure
- Implicit
- Distance, independence between the SPVs and their originators
What we know and what we don’t know about SPVs

1. Basic financial structure employed in project finance
2. Specific transaction schemes
3. General financial structure associated to SPVs

1. Are all SPVs all the same in project finance?
2. If not, which types exists?
3. What actually do the SPVs?
4. Can I see a SPV?
5. Can I see the actual ownership structure?
6. Can I see the decision-making associated to the SPVs?
7. How SPVs affect the governance of infrastructure megaprojects?
Different Perspectives considered

- SPVs as a legal constructs
- In which context to use SPVs
- Different types of SPVs
- Which functions provide the SPVs

- The Contracting network looked from the SPVs
- How SPVs change affects the structure of the contracting network
- The dynamic evolution of the contracting network: negotiation, set-up, construction, operation

**The SPV and the contracting network**

- Company A
- Company B
- Company C
- Financial Institutions
- Contractors
- Clients
- Other Stakeholders

**SPV as an “Entity”**

**SPV as an organisation**

- The SPV as organisation, the internal view
  - Board of Director
  - Internal structuring
  - Internal regulations
<table>
<thead>
<tr>
<th>Functions of the SPVs</th>
<th>Industrial Vehicle</th>
<th>Project company</th>
<th>Intermediate SPVs</th>
<th>Jurisdictional shell companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collect and own assets/liabilities</td>
<td>Sometimes</td>
<td>Intangible assets &amp; liabilities</td>
<td>Intangible assets &amp; liabilities</td>
<td>Prevalently intangible assets and liabilities</td>
</tr>
<tr>
<td>Isolate and partition: assets/liabilities, risks, responsibilities and accounting information from their originators</td>
<td>Industrial liabilities</td>
<td>Structural and systemic for the whole megaproject.</td>
<td>Critical – e.g. bankruptcy remoteness</td>
<td>Accounting isolation</td>
</tr>
<tr>
<td>Channel and transfer the risk underlying the SPVs assets/liabilities, industrial activities and enforceable responsibilities</td>
<td>Pool the risk contractually Share the risk to partners</td>
<td>Systemic financial and contractual hub</td>
<td>Critical, e.g. financial risk</td>
<td>Limited</td>
</tr>
<tr>
<td>Establish relations and embark enforceable responsibilities</td>
<td>Critical for the industrial activities undertaken</td>
<td>Systemic financial and contractual hub</td>
<td>Typically Ownership, rarely contractual relationships</td>
<td>Critical to access to specific jurisdictions</td>
</tr>
<tr>
<td>Undertake industrial activities (e.g. construction)</td>
<td>Critical</td>
<td>Rarely/ sometimes (evolution)</td>
<td>Rarely/ never</td>
<td>Rarely/ never</td>
</tr>
<tr>
<td>Manage and govern the underlying assets/liabilities, personnel and activities</td>
<td>Critical – Industrial activities</td>
<td>Govern financial assets</td>
<td>Govern the industrial vehicle and the project company indirectly</td>
<td>Almost null.</td>
</tr>
<tr>
<td>Provide access to a specific legislation and jurisdiction by their incorporation in specific countries</td>
<td>Often site jurisdiction</td>
<td>Depends</td>
<td>Depends</td>
<td>Critical, off-shore</td>
</tr>
</tbody>
</table>
What we discovered

The most relevant SPVs for the governance of large engineering projects are the *project companies* and the *industrial vehicles*.

For these organisations, the research disclosed:

- The organisational structure of the different types of SPVs
- The governance use for the megaproject of these types
- How these types are interlinked contractually, among them and with the other stakeholders
- Governance challenges and dilemmas associated with these types of SPVs
- Common contractual solutions employed
How SPVs affect the formal governance of megaprojects?

- They cluster and institutionalise homogeneous class of project stakeholders. The research identifies three key clusters: investors, developers and operators;

- They provide the governance instruments available in the corporate governance, including the state of the art of the implied rules of law.

- They establish contractual hubs improving the structural features of the project contracting network. These hubs reduce the contractual distance between project stakeholders. Technically, they behave such as “small world networks”. This has important consequences for the contracting network because they ease the protection of the security interest and improve the governability of the network.

- They provide flexible and resilient enforcing instruments, able to identify and isolate project risks and responsibilities. This enables to manage and assign residual or unforeseeable project risks that cannot be handled with traditional contracting instruments. This propriety enhances the contractual certainty and predictability of project network.
Backward slide
Methodology

Data collection:

- Interviews with experts: senior lawyers, bankers, directors of SPVs.
- Exemplifying case studies

Data analysis:

- Grounded theory approach
  - Network analysis
  - Legal interpretation, reflections
  - Exploratory case studies
Different Types of SPVs - Classification

- **Legal Status**
  - Limited Liability Company
  - Limited Liability Partnership
  - Mutual Found
  - Corporation
  - Trust

- **Lifetime**
  - Defined Purposes
  - Fenced
  - Recourse Financing
  - Transfer, sharing and spreading

- **Purposes**
  - Defined Purposes
  - fenced
  - Recourse Financing
  - Transfer, sharing and spreading

- **Activities**
  - Pre-defined Purposes
  - Apparent profit-making motive
  - Structured Finance
  - Tax optimisation
  - Price arbitrage
  - Balance Sheet management
  - Partnering and alliances
  - Isolating and homogenizing cash flows and business risk of a specific asset, asset-class
  - Eases Asset Transfer
  - Deals with legal and regulatory requirements

<table>
<thead>
<tr>
<th>SPE FEATURES</th>
<th>POSSIBLE VALUES ASSOCIATED TO THE SPE FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>SPE has legal personality</td>
<td>A A A A</td>
</tr>
<tr>
<td>Limited Liability Company</td>
<td>U/S U S S</td>
</tr>
<tr>
<td>Limited Liability Partnership</td>
<td>U/S S S R</td>
</tr>
<tr>
<td>Mutual Found</td>
<td>R R R R</td>
</tr>
<tr>
<td>Corporation</td>
<td>S S S S</td>
</tr>
<tr>
<td>Trust</td>
<td>R/N R S U/S</td>
</tr>
<tr>
<td>Defined and Limited</td>
<td>U U S U</td>
</tr>
<tr>
<td>Perpetual</td>
<td>R R R S</td>
</tr>
<tr>
<td>Pre-defined Purposes</td>
<td>A A A A</td>
</tr>
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<td>Apparent profit-making motive</td>
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<tr>
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</tr>
<tr>
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<td>A S R/N R/N</td>
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</tr>
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<td>Deals with legal and regulatory requirements</td>
<td>R U/S U R</td>
</tr>
</tbody>
</table>

- **Venue**
  - Sustainable
  - Vertical
  - Horizontal
  - Multi-
  - Intergovernmental

- **Owner**
  - Public
  - Private

- **Accounting**
  - Physical Assets
  - Human Intangible assets

- **Different Types of SPVs**
  - SPE
  - Resident in off
  - Variable Interest Vehicle (FIN 46)

- **SPE**
  - Intentionally an Off
  - Companies (e.g. Utilities, contractors, etc.)
  - The entity is primarily owned and controlled by
  - External management (directors, trustee, external administrators, etc.)
  - Passive management (e.g.,
    - Public and Private Parties (PPP) involved together into the SPE
    - Shared/distributed ownership
    - Self
    - Repackaging of the risk profile
  - Low probability of insolvency
  - Bankruptcy remoteness
  - Non-Semi recourse Financing
  - Collateralized Finances
  - High Depth/Equity Ratio
  - Physic Assets
  - Human Intangible assets
  - Financial assets and liabilities
  - Absence of Physical Assets
  - Infrastructure Related Activities (design, deliver, operate, etc.)
  - Channeling
  - Project Financing
  - Securitisation (assets & liabilities)
  - Risk Transformation
  - Insulation of Risk, Assets, Liabilities or Cash Flows
  - Dealing with legal and regulatory requirements
  - Eases Asset Transfer
  - Partnering and alliances
  - Price arbitrage
  - Tax optimisation
  - Structured Finance
  - Pre-
  - Jurisdictional shell companies
Types of SPVs Involved in megaprojects

Scope
- Industrial Vehicle
  - Project company (Financing and ownership Vehicle)
  - Other industrial purposes
  - Mixed activities
  - Top Co/ Mid Cos
  - Partitioning SPVs (similar to subsidiaries)
- Jurisdictional shell companies
- Local Company
- Off-shore Company

Ownership
- Multiple Owners: Joint Venture
- Single owner
- Single owner
- Single owner
The SPV as an integrating contracting instrument
The SPV and the contracting network

- Which are the most common configurations? Why?
- The Impact of the SPVs on the contracting structure.
- The dynamic evolution of these configurations
SPV as an “Entity”

SPV is a not specifically defined, It can be many things

SPEs are employed in many sectors other than megaprojects. The definition and understanding of the term “SPV” is scattered across different sectors and applications.

A first deliverable of the research is harmonise the definition of SPV and to describe in detail the SPV as a specific “legal construct”

- It has legal personality.
- It has limited and predefined purposes
- It is a fenced organization

To a certain degree, it is comparable to consortiums, partnerships

Additionally, I prepared two main classifications

- General one
- One Specific for megaprojects
SPV as an Organisation

- Board of Director
  - The structure of the boarder
  - A measure of decision-making power within the SPVs
    - Shapley Index
    - Different types of powers: qualified majority, veto, protection of minority shareholders, informed
  - Main concerns: agencies, leadership, conflict of interests
- The Dynamic elements
  - The legal contractual view: shareholder agreement

- Internal structuring
- Internal regulations
  - “The bible”
  - The internal policies
“Special purpose entities (SPEs) are:

(1) generally organised or established in economies other than those in which the parent companies are resident; and

(2) engaged primarily in international transactions but in few or no local operations.

SPEs are defined either by their structure (e.g., financing subsidiary, holding company, base company, regional headquarters), or their purpose (e.g., sale and regional administration, management of foreign exchange risk, facilitation of financing of investment).

SPEs should be treated as direct investment enterprises if they meet the 10 percent criterion. SPEs are an integral part of direct investment networks as are, for the most part, SPE transactions with other members of the group.”

(Glossary of Foreign Direct Investment Terms, OECD, 2001 – not published)

https://stats.oecd.org/glossary/detail.asp?ID=2515

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