

## In Practice

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# Restructuring natural resources projects in the emerging markets: features and challenges, part 2

### KEY POINTS

- Maintaining a good relationship with host governments is crucial for project sponsors operating in emerging markets.
- Creditors will often require the appointment of a chief restructuring officer (CRO) – these appointments are by no means straightforward for a natural resources project.
- Potential third party buyers and new money funding options present challenges for sponsors and lenders alike in this complex landscape.

### COUNTRY SPECIFIC ISSUES

A natural resources project in the emerging markets will be dependent, often to a great extent, on the sponsor's/ developer's relationship with the host government. Obtaining the licenses/ concessions for exploitation of a natural resource asset in the host country may have taken many years of careful negotiations. As the value of the project will be dependent on the key licenses, and as transfers are likely to require government approval (specific or implicit, and possibly even for transfer of ownership of the project at a level above the in-country project company/borrower), the lender bargaining power linked to potential enforcement and sale of the business will lack teeth if the government is not supportive of their actions. Depending on the nature of the relationship of the sponsor with the government, lenders may encounter a reluctance by the government to approve enforcement of asset security or a transfer of ownership more generally. Of course, this issue may be overcome in time if a strong alternative sponsor with a good relationship with the government steps up and shows interest, or if the economics of the concession are renegotiated in a manner acceptable to the government.

It would be naïve to assume that all natural resources projects are located in jurisdictions with a benign and open approach to private sector investment in

natural resources that may be considered to be key to the national interest. Furthermore, a change of government since the relevant concession was awarded may have resulted in a government that is less sympathetic to the project than was the case at the time of the initial award. An unsympathetic government becoming aware of financial problems for a project may be more inclined either to consider expropriation, or perhaps to revisit the original award of the concession and look for reasons (allegations of incorrect procedures, and worse) to review and

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perhaps withdraw the original concession. A government acting in this way may be inclined to try to transfer the concession to a developer more in favour with the regime at this time and who might be able to pay a higher tariff as it has not had to incur historical capital expenditure. Both debt and equity will be exposed to enhanced political risk of this kind, and discretion and confidentiality in respect of the restructuring process will therefore be key, particularly when dealing with the government and government related agencies and companies.

As would be the case in any country, relevant government bodies will be

concerned that a project's commitments to local employment and procurement (as well as to welfare, health, local business, education and other social and environmental initiatives) are complied with. Although some of the expenses related to these initiatives may not at first appear to lenders to be vital operating costs, in reality compliance with commitments of this kind may be important not only to ensure compliance with lender environmental and social policies and related borrower covenants in the debt documents, but could also be vital to the continued validity of the relevant concession (either explicitly in undertakings set out in the concession terms, or implicitly through the maintenance of important goodwill with national or regional government and the local community more generally).

Beyond the issue of the licenses/ concessions, local law issues will come under scrutiny by lenders as they consider their options. An emerging market jurisdiction may not have highly developed insolvency or security enforcement laws. As a result, various usual lender options, for example an agreed pre-insolvency restructuring arrangement or pre-pack, appointment of receivers/administrators or similar insolvency officers, enforcement of in-country asset security and sale of the project assets, may not be a viable or practical option. A complex and untested court process may be required (especially if there

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is no clear legal mechanism for navigating junior or dissenting creditors through a scheme of arrangement or a comparable cram-down), and legal recognition of priority of claims of different levels of creditors may be far from certain. Generally, bringing insolvency proceedings in-country may lead

company holds an individual out as being a director, whether the individual uses the title, whether an individual has access to board level information and whether the individual makes major decisions). A potential CRO may have more concerns than usual in accepting an appointment of this kind.

generally result in vulnerability to negative perceptions from key offtakers/buyers, contractors, suppliers and employees. There may be enhanced risk in this regard for a natural resources project, particularly in a remote location, as it could have limited scope to find alternative key contractual counterparties and employees (for example, skilled mining and or/and oil and gas professionals willing to work in emerging economies remain in short supply). Such an appointment may also create enough unease in the market to undermine any M&A 'rescue' process initiated by the sponsors, possibly at the instigation of the lenders, and could also compromise a potential equity raise.

As a matter of English law, and in various other common law jurisdictions (including Australia, New Zealand, Singapore and Ireland), there is a risk that lenders to a distressed borrower may, directly or particularly through the use of a CRO operating to an extent on the basis of instructions from them, be acting as shadow directors. To illustrate the point, under English law, a shadow director is a person or body corporate 'in accordance with whose directions or instructions the directors of a company are accustomed to act' (s 251 of the Companies Act 2006 (CA 2006); s 251 of the Insolvency Act 1986 (IA 1986); s 22(5) of the Company Directors Disqualification Act 1986) – excluding those advising in a professional capacity only. Therefore, if the scope of the CRO's appointment provides the CRO with enough power to influence decisions of the board and the lenders are granted too wide a power to instruct the CRO, then whether or not the CRO is actually appointed to the board, the lenders may be at an elevated risk of being shadow directors. This risk may be further enhanced in a natural resources restructuring where the location and nature of the project, perhaps combined with the lack of specialist restructuring experience in the lender group as noted above, may result in a request for the CRO to have considerably more influence and more direct and frequent lines of communication with creditors than is usual.

Given that the duties of a shadow director align to those of an 'actual' director

### 'Generally, bringing insolvency proceedings in-country may lead to significant uncertainty as to outcome'

to significant uncertainty as to outcome. A well-structured project financing will probably have ensured alternatives through use of offshore security (for example charges and pledges over shares in an offshore holding company), but the palette of lender contingency options may be much more limited than lenders would like or might at first assume to be the case given the constraints of the concession agreements and in particular the effects of a change of control.

#### CROS' AND DIRECTORS' DUTIES

There has been an increasing trend for creditors to insist that a specialist turnaround professional (in the role usually known as chief restructuring officer or CRO) should be appointed by the distressed creditor. This may, but will not necessarily, be a board level appointment. The appointment of a CRO could well be a requirement of continued support by lenders to the distressed project.

The legal and practical implications of this are generally not unique to an emerging market project restructuring. However, given the potentially enhanced risks to directors of a distressed natural resources company, as discussed below (additionally, whether or not the appointment is at board level), the CRO may well become a de facto director or shadow director with attendant duties and responsibilities. Which category the CRO falls into is fact dependent. For instance, in *Secretary of State v Tjolle* [2010] UKSC 51, Jacob J stated that factors indicating a de facto directorship include whether the

The prospective CRO appointment will be occurring in the context of a more limited pool of potential CROs than may be the case for other businesses. Finding a candidate with suitable industry and regional experience may not be straightforward, and current sponsor senior management is likely to be uneasy about the introduction of a new person to sensitive discussions with government officials, contractors, suppliers and buyers with whom they may have spent many years developing and nurturing relationships.

In the context of the appointment of a CRO, it is important not to understate the key role of the project's management team in the prospects for success or failure of the troubled project. Lenders will need to be careful that the scope of the CRO's appointment does not undermine the existing management to the point where they choose to leave at a crucial juncture in the life of the business, perhaps also bringing a claim for constructive dismissal. The spectre of constructive dismissal of executive management has loomed large in number of recent high profile restructurings.

For a sponsor that is a listed company, the appointment of a CRO will usually require an announcement. For instance, under Chapter 9 of the UK Listing Rules and under the NYSE Listed Company Manual, the appointment of a CRO to the board, or any appointment that therefore alters the roles of the board, must be announced. As will be the case with any disclosures or leakages that indicate financial difficulties, this may result in concerns at host government level, or more

**Biog box**

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under English law (s 170(5) of the CA 2006 providing that the director's general duties, as set out in ss 171-177 of the CA 2006, apply to shadow directors), lenders potentially acting as shadow directors will, like the sponsor's directors, run the risk of undertaking wrongful trading by the business. In an English law context, personal liability for wrongful trading carries risk under s 214 of the IA 1986 in circumstances where: (i) a company has gone into insolvent liquidation or insolvent administration; (ii) at some time before the commencement of the winding up or insolvent administration of the company, a director at the time (including a de facto director or shadow director) knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation/administration; and (iii) that director (after satisfying the condition in (ii)) failed to take every step with a view to minimising the potential loss to the company's creditors.

Similar rights exist under many potentially relevant jurisdictions, for example, the Netherlands, Singapore, Brazil and Australia and others. This is a risk that has to be carefully considered especially where the prolonged trading has eroded the liquidity of the project company and it finds itself unable to fund any safety or other de-commissioning costs.

Although these risks are obviously by no means unique to a natural resources project, they may be increased by some of the unique operational aspects of a business of this kind. In addition to the usual essential operating costs to keep the project going (fuel and other input costs, salaries, local taxes and royalties and similar), others may at first appear more discretionary. For example, some of the costs related to social and environmental initiatives noted above, and perhaps local security measures, may in reality be essential to maintain operations (perhaps by helping to keep the required licenses or concessions in good standing). Policy lenders are also likely to insist that expenses of this kind are met. Directors will therefore need to balance the need to meet crucial expenses as they fall due and their

fiduciary duty to protect creditors' interests.

If the directors cannot satisfy themselves that there is no reasonable prospect of avoiding an insolvent winding up, on the basis that this is the stage where the directors' duty to act in the best interests of the members of the company switches to a duty to act in the best interests of the creditors (s 170(3) of the CA 2006 provides that the duty to act in the best interests of the company is subject to any rules which require the directors to act in the interests of the creditors, such as s 214 of the IA 1986 wrongful trading provisions), then the implications for all stakeholders (creditors, shareholders and others) are likely to be particularly traumatic. It will not be straightforward for a new operator to take over the operations of a natural resources project, given

above assumes that the relevant commodity/product prices are not in permanent decline, and there may therefore be significant upside value in the project in an improving commodity price environment. This may result in shareholders (institutional, specialist funds or others) subscribing for a rights issue, either to fully deliver the project, or at least to bring the debt structure to a sustainable level.

Shorter term funding to bridge the period before a sale or market pick-up may be available through factoring/receivables discounting facilities, which are often permitted under suitably flexible debt incurrence covenants in project finance terms.

Other potential short and longer term funding options may exist: specialist infrastructure funds, suppliers/

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location, technical, market, environmental and other risks, at least without extensive diligence.

### POTENTIAL BUYERS, NEW EQUITY AND STRATEGIC INVESTORS

If there is a prospect of sale of the project to a third party buyer, particularly one that may commit to repay project debt or ensure significant deleveraging, lenders are of course likely to put significant pressure on the sponsor to pursue this option. This will introduce one or more third parties to the restructuring process, with implications both for timing and deal terms (for example, introduction of conditions regarding deleveraging/debt repayment that are deemed to be acceptable to lenders). If the sponsor is a public company, this may require occasional consultation with the relevant takeover panel or other financial regulatory body, particularly if restructuring terms could impact the terms of the proposed offer.

Of course, much of the process described

buyers (perhaps by way of forward sale arrangements for products) and other strategic investors and offtakers may be considered. Ultimately, bearing in mind the somewhat illiquid nature of a businesses of this kind and the imperative to keep operations going to salvage value for investors and creditors and to avoid a total write-off of their indebtedness, certain existing project lenders may be willing to consider making new money funding available to the project, probably at 'super senior' level of priority compared to existing debt and almost certainly on more restrictive terms than applied to the original project financing.

### CONCLUSION

Although the range of issues relevant to any restructuring may apply to a distressed natural resources project, our experience has repeatedly shown that the various features highlighted above make it a different proposition that presents certain unusual, and sometimes unique, challenges. ■