

France's first defence PPP takes to the skies

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France's Ministry of Defence closed its first ever public-private partnership deal this month in what is being described as a 'pioneering' deal and a 'cultural shift' for the country's defence authority.

The news signals the continued broadening of appeal for the PPP model beyond its core markets, when a country historically so wedded to the public sector - France's railways are still under national ownership - feels able to allow private participation into a sector as sensitive as defence.

Matthieu de Varax, the Mayer Brown partner who advised the sponsor on the deal, describes it as a "complete cultural shift in the way the French Ministry of Defence deals with procurement."

In this study, *IJ* gets under the skin of this important precedent, which has the potential to herald PPP's arrival as a core procurement route for France's defence ministry.

EAALAT - French army flying school

The defence project is located in Dax, in the south west of France and involves the provision of helicopter flight training at the army's light aviation school - known by its French acronym, EAALAT.

The sponsor is contracted to provide a set number of flying hours to the defence ministry over a 20-year period and to provide the helicopters in which to implement the project. The Ministry of Defence specified the model of helicopter - the Eurocopter EC120B - to be used. What the sponsor is not required to provide is personnel.

The project also allows for the sponsor to seek 3rd party revenues, though this depends on them finding the time and resources to do so.

The sponsor - DCI/Proteus

The winning bidder was a joint venture between Défense Conseil International (DCI) and Proteus Helicopters.

DCI is a French defence training specialist, which specialises in transferring French defence know-how to foreign defence bodies.

It also has a financial arm which offers equity financing to small- and medium-sized firms operating in the defence sector.

Its partner, Proteus Hélicoptères, is a French helicopter operator, providing services to the public and private sectors. It operates, for example, in the offshore rig arena and it also works with the French food safety agency - dropping rabies vaccines from the air.

The partners have a two year period at the start of the concession to put everything in place. The concession will then run for a further 20 years, during which the training will be provided.

Debt has been provided 50:50 by joint MLAs Dexia and BRED Banque Populaire. The sponsors took legal advice from Mayer Brown in Paris and financial advice from Nova Capital.

In the footsteps of the MoD

This deal owes much to MoD precedents set in the UK.

Experts believe it is France's first 'contrat de partenariat' to involve movable assets - an issue which has been resolved on numerous occasions with UK MoD PPP deals, the latest of which being Serco-Denholm's FPMS concession with the Royal Navy that closed at the end of last year.

According to Mireille Barthez, of the project finance team at Dexia in Paris, the movable asset component makes this "a pioneering project."

Like many defence PPPs, the flying school was triggered by a perceived need to update the technology currently in use. In the case of Dax, the school was operating a fleet of 50-60 Gazelle helicopters, which were around 30 years old.

The rate at which military kit goes out of date can be hard to predict - which is why Britain's MoD has frequently opted for 'break point' clauses, where the concession can be reviewed after a set period, with an option to end it or to extend it.

The French defence ministry has not gone for this option - perhaps because its current fleet of training helicopters lasted 30 years, whereas this PPP expires in just 22 years.

Matthieu de Varax, senior partner at Mayer Brown's Paris office and legal adviser to the sponsor on the deal, explains that "the French defence ministry can walk away at any time - but it would have to indemnify the sponsor fully."

Another aspect of the movable asset PPP is commonly that - unlike a hospital or school - the extent of its use is not automatically guaranteed.

This is why usage guarantees are written into the contracts. In this case, the Ministry of Defence is committing a certain number of flying hours per year. The amount, which has been set initially to 16,000 hours, can "vary within a certain range over the contract period at the request of the defence ministry," explains de Varax.

In practice, the defence ministry has said it expects to use 22,000 hours per year, based on past experience.

Any variation will obviously impact on the scope for 3rd party revenues to be earned. Although the possibility for that is written in to the contract, de Varax is doubtful about its likelihood in practice.

"We have to be realistic", he says. "The sponsor has worked out how many helicopters it needs to fulfil the defence ministry's needs - 36 - and it will buy that many. One possibility I can see is that the school closes in August, so perhaps then."

No doubt that region of France has some wonderful views for tourists to gaze upon at from the vantage point of a Eurocopter.

One innovation which the French Ministry of Defence has not copied from the UK in this instance is the concept of sponsor reserves.

Under the sponsor reserve system, the personnel implementing the project are employed by the sponsor but given military training. They take on the status of reservists and are ready to be called up by the MoD in the event of war.

In the Dax project, all staff to whom that could apply will be military personnel.

SPVs, lessors and lessees: procuring the assets

DCI-Proteus was supported in the joint venture by Nova Capital Group, a Parisian investment and financial advisory company that specialises in helicopter financing and leasing.

Nova Capital is a minority partner in the operating SPV, but also has its own SPV in which DCI and Proteus have token stakes. The Nova SPV will own the helicopters and lease them back to the operating SPV.

First, however, DCI and Proteus - funded by the debt facility - will purchase the helicopters and have them customised to meet the needs of the customer.

Once this is complete, they will be sold to Nova Capital's SPV - the lessor - which will lease them back to the operators. In this way Nova Capital avoids the risks associated with the customising process.

The helicopter chosen for Dax is the Eurocopter EC120B. It is a recently designed and user-friendly light single engine aircraft that is particularly well suited to training activities. It is the quietest aircraft in its class and benefits from a simple and easy maintenance programme, meaning a relatively low operating cost.

As with other movable asset PPPs, the asset's residual value also plays its part in this deal. The defence ministry will have the option to buy the helicopters at the end of the 22 years, but the risk inherent in predicting their residual value has been left in this case with Nova Capital, who will retain ownership of the aircraft for the duration of the concession.

Conclusion: Pour encourager les autres?

France's defence ministry has used PPP before - but only in the provision of barracks to the gendarmerie, which doesn't have the same level of sensitivity as military training.

Incidentally, military accommodation is also as far as the US defence department has gone with public-private partnerships.

However, France's defence ministry has expressed a desire to realise €1.5 billion in savings through using PPP. Hot on the heels of this deal, we are now expecting news on a training centre PPP for the air force, planned at Cognac.

Will French willingness to use the model in the defence sector embolden other countries in this regard?

The Netherlands has used PPP for an army barracks and is another country with growing enthusiasm for this model.

Israel last year awarded a 10-year concession to provide its air force with a flight training centre - involving the supply of simulators, maintenance and training services.

That project also makes a feature of its capability to provide training to the civilian sector as well.

South Africa is reported to be dipping its toe in the water with an air base management and upgrade PPP, while Brunei has also declared its intention to bring in private finance in the development of its defence capabilities.

The private sector has consistently proved itself a reliable partner to the UK's Ministry of Defence - if it can do the same the other side of the channel, this deal will truly be worthy of 'pioneer' status.

The project at a glance

Location	Dax, France
Description	The SPV will provide 36 helicopters and 22,000 hours of training per year to the French army over 23 years
Sponsors	Défense Conseil International (DCI) and Proteus Hélicoptères (Proteus), with Nova Capital Group
Project Duration	22 years
Construction Stage	2 years
Total Project Value	€60 million

Total equity	€6 million
Equity Breakdown	50:50
Total senior debt	€54 million
Senior debt breakdown	50:50
Debt:equity ratio	90:10
Mandated lead arrangers	Dexia Bank and BREN Banque Populaire
Legal Adviser to sponsor	Mayer Brown
Financial Adviser to sponsor	Nova Capital Partners

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