Public Private Partnerships Legal Structuring

Project made possible through funding by:

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CLDP

COMMERCIAL LAW DEVELOPMENT PROGRAM

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Today's Agenda

1. Discuss the Public Private Partnership **(PPP)** relationship to development
2. Identifying the most suitable PPP type
3. Explain a typical PPP structure
4. Introduction of critical PPP documents
    - Concession Agreement
    - Implementation Agreement
    - Direct Agreements
5. Question and Answer Session

PPPs and Development

PPPs present a number of advantages for the public sector to exploit. These include the ability to:

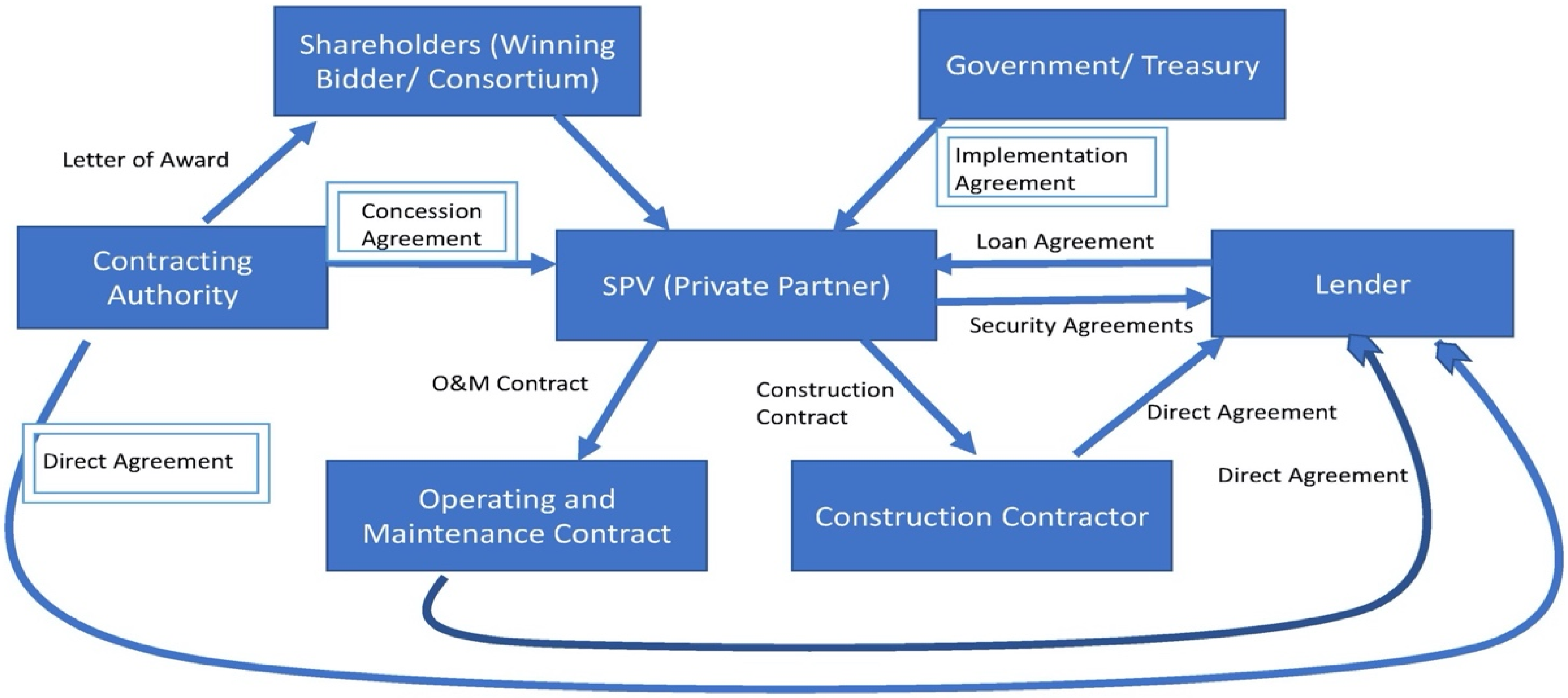
- Raise additional finance in an environment of budgetary restrictions
- Make the best use of private sector operational efficiencies to reduce cost
- Increase quality of service to the public; and
- Speed up infrastructure development.

Selection of The Most Suitable PPP Type

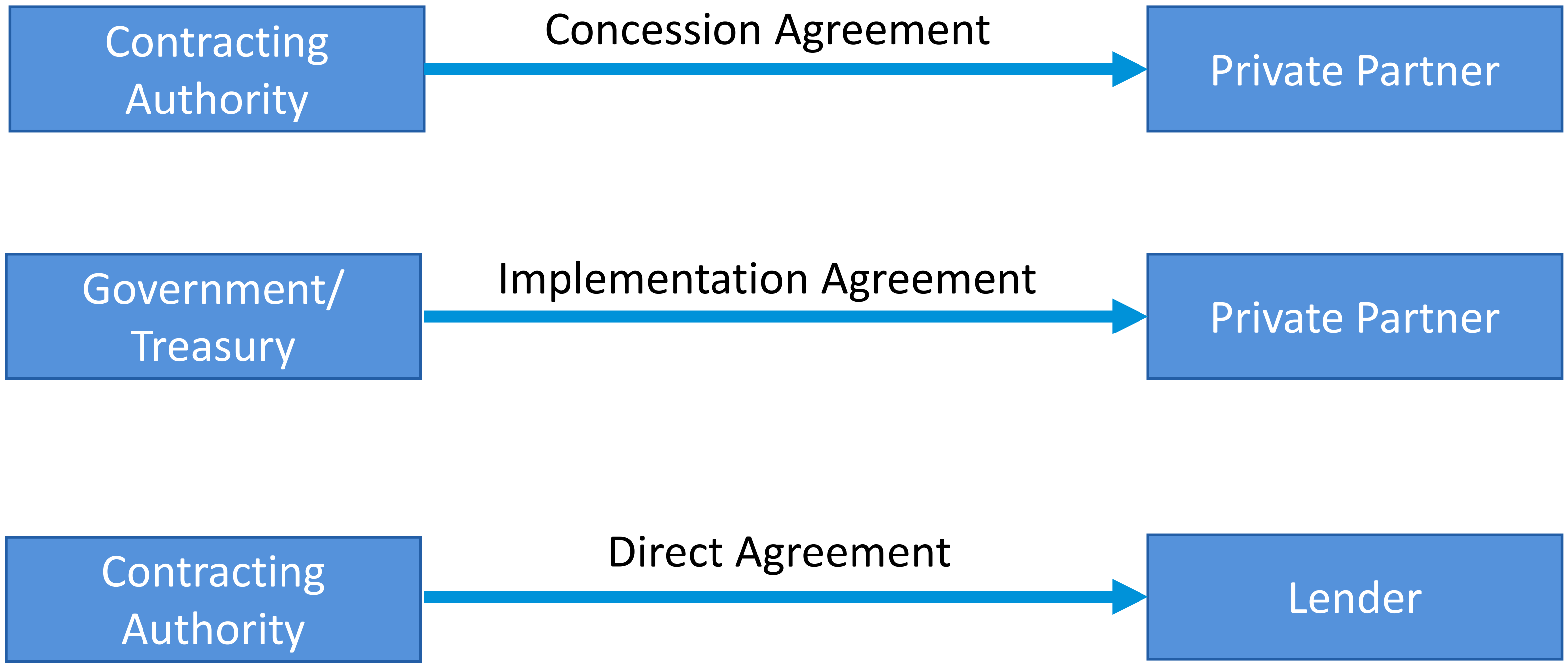
PPP arrangements should not be entered into merely for the sake of undertaking a PPP project. Before a PPP arrangement is agreed upon, the responsible authority **(Contracting Authority)** should:

- Conduct a detailed review of the costs and benefits of private sector involvement versus public alternatives to ensure that a PPP enhances the public benefit;
- Carefully match the degree of private involvement to the objectives and needs of the project and the public; and
- Consider the appropriateness, cost, the ability to effectively implement and manage the project.

TYPICAL PPP STRUCTURE



Key agreements in a PPP



Concession Agreement

- The Concession enables the private partner to finance, construct, operate and maintain a project in exchange for the right to collect revenues or be paid for a period of time.
- Most Concession Agreements are entered into for **BOT, BOOT or DBFOM** projects.
- Because of the size of the required investment, concessions are often given for a long period of time. Usually between 25-30 years. This allows enough time for the private partner to recover the investment.

Concession Agreement – Key Features

- Set out the **objectives** and defines the **scope** of the project.
- Transfers the necessary **rights** to the private party **to develop and operate** the project.
- Specifies **performance criteria and parameters** for the project.
- Provides a source of **revenue** for private partner.
- Establishes a **framework of rights and responsibilities** between the parties.
- **Allocates risk** between the parties.
- Restricts **change in control** of the private partner.
- Includes a **termination regime**.
- Spells out the **hand over process** of the asset back to the Government.

Transferring rights to the private partner

Concession Agreement grants certain rights from the Contracting Authority to the Private Partner.

In some projects, the Private Partner may buy the assets from the Contracting Authority (and pay up-front or in instalments over the term of the concession).

In other projects, the Contracting Authority will not transfer ownership of any property or asset; but instead, grant access rights to the Private Partner to develop and operate the project.

Critical to ensure the Concession Agreement transfers all the property, access and operational rights that private partner needs to fulfil its obligations under the concession.

Scope and parameters of the project

A Concession Agreement will also specify the intended performance parameters of the project.

Development projects will typically have parameters relating to the:

Development stage	Operational phase

Development Stage parameters

Parameters should not be defined in detail.

Common approach is to set out certain desired performance specifications for the project.

Private partner will then take responsibility for designing and constructing a project that meets those performance specifications within the time frame required by the Concession Agreement.

Operational stage parameters

Concession Agreement will set out a series of key performance indicators to ensure certain operating standards in the project.

Contracting Authority should ensure that the technical operational parameters are realistic and achievable by the Private Partner.

Operational parameters usually passed through to the operator under the O&M agreement between the Private Partner and the O&M operator.

Ultimate responsibility for meeting the operational parameters would lie with the Private Partner.

Financial Terms

Availability payment model - paid by the Contracting Authority to the Private Partner.

End-user pays model – users pay a fee or tariff for using the services (or products) provided (or produced) by the project.

Shadow tolls - For certain transportation projects, an undertaking by the Contracting Authority to pay the Private Partner per user..

Royalty fee - For concessions relating to existing infrastructure without any additional development component, a right for the Private Partner to charge the end-users for the service provided in exchange for a fee payable to the Contracting Authority for the right to operate the concession.

Change in Law Clause

- A **change in the law** applicable to the project presents a serious potential risk to the ongoing viability of the project, especially one located in an emerging market.
- **Why?** - plays an important role in maintaining or restoring the economics of a project following a change in law that adversely impacts the project.
- **Purpose** - to allocate the risk that a change in law will adversely affect the economics of a project.
- **Aim** - restore the Private Partner to the same position it would have been in if the change in law had not occurred.
- **Typical clause** - allocates risk of a change of law to the Contracting Authority.
- **Current practice** - Clauses often apply only to changes in law that affect the project disproportionately as compared to similar businesses.

Force Majeure

- **Force majeure events** - acts, events or circumstances beyond the reasonable control of the party concerned.
- A force majeure definition will be a combination of a general description of unforeseeable events and an itemised list of specific events.
- Some Concession Agreements in emerging jurisdictions contain "**political force majeure**". These are events that result from action or inaction by a governmental authority.
- **Consequences** of a force majeure event can be pivotal to the development and operation of a project.
- Usually party affected by a force majeure will be **excused from performance** during the force majeure. If necessary the term of the concession may be extended.

Force majeure definition

Sample definition

Force Majeure Event means any circumstance not within a party's reasonable control including, without limitation:

a) acts of God, flood, drought, earthquake or other natural disaster;
b) epidemic or pandemic;
c) terrorist attack, civil war, civil commotion or riots, war, threat of or preparation for war, armed conflict, imposition of sanctions, embargo, or breaking off of diplomatic relations;
d) nuclear, chemical or biological contamination or sonic boom;
e) any law or any action taken by a government or public authority, including without limitation imposing an export or import restriction, quota or prohibition, or failing to grant a necessary licence or consent;
f) collapse of buildings, fire, explosion or accident;
g) any labour or trade dispute, strikes, industrial action or lockouts (other than in each case by the party seeking to rely on this clause, or companies in the same group as that party);
h) non-performance by suppliers or subcontractors (other than by companies in the same group as the party seeking to rely on this clause); and
i) interruption or failure of utility service.

Political force majeure examples

Political Force Majeure Events include:

a) acts of terrorists, blockade, embargo, riot, public disorder, violent demonstrations, insurrection, rebellion, civil commotion and sabotage;

b) politically motivated, strikes, lockouts, work stoppages, labour disputes, or such other industrial action by workers;

c) failure or inability of the Private Partner to obtain or renew any consent, on terms and conditions as favourable in all material respects as those contained in the original consent;

d) any action or failure to act without justifiable cause by any government authority;

e) expropriation or compulsory acquisition; or

f) any legal prohibition on the Private Partner's ability to conduct the Private Partner's business.

Termination provisions

- **What are they?** List of events that give rise to a party's right to terminate the concession and the consequences applicable to a termination.
- **Grounds for termination**. Typically, a Concession Agreement can be terminated by either party because of:
  - the fault of the other; or
  - a prolonged event of force majeure preventing performance for a sustained period.
- The events of default applicable to the Private Partner should include:
  - adequate notice; and
  - cure periods,

  to allow the Private Partner (and their lenders) sufficient time to remedy the problem.
- **Lenders will not accept**:
  - hair-trigger events of default allowing the Contracting Authority to terminate the concession with limited notice or ability to cure; or
  - a concession that automatically terminates following an enforcement of lender security.

Termination compensation

- A **bankable Concession Agreement** traditionally required the Contracting Authority to pay compensation to the Private Partner:
  a) following the termination; and
  b) irrespective of the grounds of termination, including because of Private Partner default.

- This was **justified** on the grounds that:
  - the Contracting Authority would have received **some benefits** from the partial development of the project; and
  - it would be **unjust enrichment** if no payment were made for the part of the project provided.

- **Banks** often **required termination compensation** in all scenarios to ensure that their loans were repaid.

Traditional approach to compensation

For Private Partner default, compensation equal to :

- the outstanding debt (principal, interest and fees) payable to the lenders; and
- any hedging termination payment.
- In developed markets, sometimes no compensation paid.

Contracting Authority default or political force majeure, compensation equal to:

- outstanding debt (principal, interest and fees) remaining payable to the lenders;
- any hedging termination payment;
- total amount of equity (and shareholder loans) invested into the project by sponsors; and
- amount reflecting agreed rate of return on the equity contributed by the project sponsors.

For a termination following a prolonged event of force majeure, compensation equal to:

- outstanding debt (principal, interest and fees) payable to the lenders;
- any hedging termination payment; and
- some amount of equity, however, not as much as would be payable following a default by the Contracting Authority.

Market value approach to compensation

More common in developed markets.

Under this approach:

a) the Contracting Authority will, unless the lenders have stepped in, retender the project;
b) If a buyer is found, Contracting Authority will deduct the costs incurred in the retendering process and pass the remaining amount paid for the project by the buyer to the original Private Partner; and
c) Private Partner will apply such amount to repay outstanding debt and hedging counterparties.

If no buyer is found, the Private Partner will not receive any compensation.

NOTE: If a Concession Agreement lacks an adequate compensation regime following the termination of the concession, it is likely that the lenders will increase the pricing applicable to the loan facility to offset the increased risk

Handover provisions

- Every Concession Agreement will have an **end of term** handover provision.
- The handover process will begin a year or two before the end of the term.
- Accordingly, the Concession Agreement will typically require that the:
    a) Assets are **transferred back** to the Contracting Authority;
    b) Assets are returned **free of all security interests** or other encumbrances;
    c) Assets be in **good working condition**, normal wear and tear excepted and **fit for continued operation**;
    d) Private Partner provide the Contracting Authority with all **operating and maintenance manuals**; and
    e) Private Partner **provide** appropriate **transitional services** allowing for a seamless transfer from one party to the other party, including the provision of adequate training for the public-sector employees (if appropriate).

Dispute resolution provisions

- Governing law and dispute resolution provisions contained in a Concession Agreement impact enforceability of the agreement.

- Typically, Agreement is:

  a) governed by the law of the country in which the project is located; and

  b) will require any dispute resolution to take place with a local judicial or administrative proceeding.

- However, Private Partner's and lenders increasingly push for arbitration in a neutral jurisdiction instead especially for PPP projects in emerging markets

Insurance provisions

- Most Concession Agreements will have provision requiring Private Partner to maintain appropriate insurance.

- Typically, this will include:
  a) **casualty insurance** – covering the risk of loss during both the construction phase (if there is one) and the operational phase of the project; and
  b) **liability insurance** – covering risk of injury to third parties.

- The parties need to ensure that insurances are adequate for the project and are obtainable.

- Check if any requirements that some or all the insurance is placed with **local insurance** providers. This could raise some bankability issues if required insurance cannot be found locally.

Transferability provisions

- Concession Agreement should not be transferable by either party without the other's consent.

- However, lenders will insist as a **condition precedent** to advancing funds that:

  a) the Private Partner grant **security over its rights** under the Concession Agreement; and
  b) the Private Partner, the Contracting Authority and the lenders enter into a **direct agreement**.

Direct Agreement

- A direct agreement is a tripartite agreement between the Private Party, the lender to a PPP project (or the security trustee (on behalf of the lenders)) and the Contracting Authority.

- A direct agreement supplements the security granted over a Concession Agreement.

Direct Agreement – Key Features

- Consent from the Contracting Authority to, and acknowledgement from it of, the Private Partner’s assignment by way of security of the Concession Agreement.
- A standstill or suspension period and cure rights for the lenders if the Private Partner defaults under the Concession Agreement.
- Temporary step-in and step-out rights allowing the lenders or their appointee to exercise the Private Partner’s rights under the Concession Agreement for a limited period.
- Transfer provisions facilitating the transfer of the Concession Agreement to a new party.
- Other provisions stemming from due diligence on the project and Concession Agreement.

Step-in and step-out rights in direct agreements

- Sometimes termination rights arise with limited or no ability for the defaulting Private Partner to remedy the problem.
- A direct agreement may restrict the Contracting Authority from exercising its termination rights without first giving written notice to the lenders and allow them time to cure the breach.
- A direct agreement will provide that if the Private Partner defaults under the Concession Agreement, the lenders can "step in" and exercise the Private Partner's rights before taking any formal enforcement action.
- Lenders will also have the right to "step out" of the concession agreement once they have "stepped in."
- The Contracting Authority will have some concerns regarding the exercise of step-in rights if there are outstanding liabilities from the Private Partner

Sale and novation rights

Worst case scenario: a direct agreement will facilitate a sale of the project:

- A direct agreement provides a mechanism to facilitate the transfer of the project to a new Private Partner
- The Contracting Authority will be obliged cooperate with any transfer
- In the case of a permanent transfer by way of novation:
  - The new party will be referred to as the “substitute obligor” and become solely liable for the ongoing performance of the Private Partner’s obligations under the Concession Agreement
  - Also responsible for certain past liabilities to the extent that any remain outstanding
- The Contracting Authority will have concerns regarding the suitability of the new party to perform

Additional provisions stemming from due diligence

Direct agreements often used to include clarifications or amendments as a result of the due diligence performed by the lenders

A direct agreement can:

- Override any pre-emption rights that might interfere with the enforcement of either asset level or share security.
- Obtain any required consent from the Contracting Authority to a change of control of the Private Partner as a result of any enforcement of share security.
- Extend terms of any license or other IP rights that may be required to operate the project to the lenders, their appointee, and their transferees.

Additional provisions stemming from due diligence continued

- Direct any payments to be made by the Contracting Authority to the Private Partner to a secured account held for the lenders and exclude any set-off rights in respect of those payments that the Contracting Authority may be entitled to exercise under the Concession Agreement.
- Restrict the Private Partner and the Contracting Authority from agreeing to any amendments of the Concession Agreement without the prior approval of the lenders.
- Amend any generally onerous terms of the underlying Concession Agreement that affect the overall bankability of the project.

Implementation Agreement

An Implementation Agreement provides for direct contractual obligations and undertakings between the Government (other than the Contracting Authority) and the Private Partner.

Implementation Agreement Continued

Implementation Agreements are more common when the Government is not a party to the Concession Agreement but the PPP project will require inputs from the Government in the form of:

- Assistance in obtaining required consents
- An undertaking to ensure that the Contracting Authority performs its obligations under the Concession
- A guarantee, where there is a concern on the part of the Private Partner that the Contracting Authority may not have the financial standing to fulfil its obligations; and
- Undertakings on export and import duties and taxation of the Private Partner.

The Implementation Agreement will typically include undertakings by the Private Partner to the Government regarding compliance with environmental laws and abiding by any environmental or social management frameworks.

Questions and Comments?

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