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First Issue - December 2008

STANDARDISED PPP PROVISIONS

for

USER PAY PPP PROJECTS

("Standardisation")

This Standardisation is issued by the Ministry of Finance, Government of Pakistan, acting through the Infrastructure Project Development Facility ("**IPDF**"). This Standardisation is published with the intent to serve as the baseline for negotiations and drafting of PPP Agreements for PPP Projects where the cash flows consist primarily of charges paid by end users of the Project and where the Federal Government has direct or indirect, actual or contingent financial exposure. This Standardisation is also available as a useful reference tool for PPP projects that do not entail financial exposure of the Federal Government. This User Pay PPP Standardisation is a modification of the Unitary Payments based Standardisation issued in September 2007, and highlights key areas of User Pay PPPs.

The Federal Government is actively pursuing related initiatives towards development of a policy of the Federal Government for Public Private Partnerships ("**PPP Policy**"), a law regulating Public Private Partnerships (**'PPP Law'**), as well as manuals or guidelines that, taken together, will provided the framework for project identification, development, approvals, reporting and monitoring ("**Regulatory Instruments**"). References in this Standardisation to the provisions or requirements under the Regulatory Instruments are to be understood as the *likely* shape such provisions and requirements will take in these instruments in their final form. The provisions in this Standardisation remain subject to the Regulatory Instruments, as and when promulgated or prescribed.

The Ministry of Finance may from time to time issue practice notes amending, modifying, replacing or supplementing the contents of this Standardisation. All users of this Standardisation are notified that, with the exception of signed PPP Agreements, the Ministry of Finance retains absolute discretion in issuing such practice notes and no right shall be acknowledged in any person (including bidders or parties actively negotiating a PPP Agreement under this Standardisation) in retention of any or all provisions of this Standardisation in their current form.

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PREFACE

(A) Introduction

(A1.1) This Standardisation describes the key issues that are likely to arise in public private partnership ("**PPP**") projects where the cash flows required to finance the project consist primarily of fees or charges paid by the public end users using the project services ("**User Charges**"). This Standardisation is therefore referred to as the "**User Pay Standardisation**" (also, "**User Charges Standardisation**").

(A1.2) This User Pay Standardisation builds on the Standardisation issued by IPDF (following approval of the Task Force on PPPs established by the Federal Government) in September 2007, that was directed at PPP projects where the cash flows required to finance the project consist exclusively of the periodic 'annuity' payments made by the "Institutions" through "Unitary Payments[1]" (the "**Unitary Payment Standardisation**"). The treatment of the risk allocation and underlying principles for Unitary Payment PPP projects in the Unitary Payment Standardisation is comprehensive enough to work equally well on a wide range of issues that are common with User Pay PPPs. However, as the User Pay PPPs pose a different regime for the risk allocation in some critical areas, it was considered feasible to provide a 'stand-alone' Standardisation for User Pay PPPs. References hence forth to 'Standardisation', 'PPP', 'PPP Agreement' and 'Projects' are to 'User Pay Standardisation', 'User Pay PPPs', 'User Pay PPP Agreement' and 'User Pay Projects', respectively, unless expressly stated otherwise.

(A1.3) User Pay PPPs may at a later stage be regulated by the provisions of the Regulatory Instruments. This Standardisation prescribes how these key issues must be dealt with in a PPP Agreement in a manner that achieves, *inter alia*, the fundamental requirements of "*substantial risk transfer*", "*value for money*"

[1] The terms Institution and Unitary Payment are described in detail later.

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and "*affordability*" in PPP projects. Pending the definition or treatment of these requirements in the Regulatory Instruments:

'*substantial risk transfer*' means transfer of the risks in the Project to the Private Party to a level that achieves and maintains value for money for the end users and/or the Institution;

'*value for money*' means that the implementation of the PPP Project results in a net benefit to the the end user and/or the Institution defined in terms of cost, price, quality, risk transfer or a combination thereof; and

'*affordability*' means the threshold of the User Charges, as demonstrated in the pre-feasibility / feasibility study for the Project for the targeted end-user segment, for the services delivered through the Project are reasonably affordable for the end-users, and, in relation to the Institution, means the ability of the Institution to meet any financial commitment likely to be incurred in relation to the Project from its existing or future budgetary allocations, including any viability gap funding.

(A2) Key issues that are not capable of standard treatment (either because of sector-specific requirements or because of specific circumstances affecting a particular PPP) are identified in this Standardisation but are not given detailed consideration. Institutions must seek to identify such issues during the feasibility study phase of a PPP, and highlight these to the Approving Authority in the related applications for the Approving Authority's Approvals. [2]

(A3) The objectives of this Standardisation include the promotion of a common understanding of the technical, operational and financial risks that are typically encountered in PPPs, a common understanding of how such risks must be transferred or shared among the parties involved in the delivery of PPPs, a consistent approach to risk transfer, risk sharing and value for money across

[2] There will likely be several 'stage-wise' approvals for PPP Projects. These will be listed in the Regulatory Instruments. Unless concluded otherwise, references to 'Approving Authority' in this Standardisation are references to the Ministry of Finance of the Federal Government, acting through the agency of IPDF.

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PPPs, and a reduction of the time and cost of negotiation of the parties involved in a PPP.

(A4) It is important to note that this Standardisation focuses on the appropriate risk profile of PPPs. It does not focus on whether PPPs are suitable mechanisms for service delivery (as opposed to "internal" mechanisms for service delivery traditionally used by the public sector institutions undertaking PPP projects[3] ("**Institutions**")), nor does it focus on the identification of the types of PPPs that are suitable for pursuit by such Institutions. The responsibility for identifying whether a PPP is suitable for an Institution's strategic and operational needs and requirements lies with the Institution, since it is best placed to identify those needs and requirements.

(A5) Sector-specific issues are not addressed in this Standardisation. Accordingly, this Standardisation is no substitute for a comprehensive consideration of all issues that may be relevant to a PPP, when viewed in the context of the specific sector to which it relates. Rather, its aim is to assist in the conduct of such consideration. The Approving Authority intends to prepare, in due course, sector-specific standardisations, which will complement this Standardisation.

(A6) While there are a large number of 'nuance' changes in this User Pay Standardisation, the **key areas** where this User Pay Standardisation differs from the Unitary Payment are as follows:

(a) The market or revenue risk rests with the Private Party. The essence of a User Pay PPP project is that the Private Party will bill and collect the User Charges *directly* from the end users in exchange for the services provided to such end users. Where an Institution itself collects the service charges and makes periodic payments to the Private Party, then that becomes a Unitary Payment regime – and not a User Charges based regime - in that in the former the 'payment and collection risk' is

[3] Subject to any contrary requirements under the Regulatory Instruments, these Institutions could comprise public bodies, attached departments of Ministries, Courts, statutory authorities, state owned business enterprises, Constitutional bodies or any other entity or concern that is under statutory, legal or executive responsibility to perform a public function and which will in common parlance be referred to as a 'public body'.

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not carried by the Private Party. The matrix below reflects the differences in terms of revenue or market related risks in User Pay PPPs.

Risk	**Unitary Payment**		**User Charges**	
	Institution	PP	Institution	PP
Market/Demand Risk	X			**X**
Collection Risk	X			**X**
Customer Default Risk	X			**X**
Billing Risk	X			**X**

(b) As the Institution does not make any payments which it can withhold partly or wholly to penalise non- or poor performance by the Private Party, a "performance security" is required upfront from the Private Party;

(c) Early Service Commencement, or phased Service Commencement, is encouraged (as this facilitates early provision of infrastructure services to the end users without the constraining influence of Institution's budgetary allocations as is the case with Unitary Payment PPPs);

(d) The initial setting of User Charges is based on established principles for tariff setting, along with readjustment during Project Term being recognised as a possibility subject to the procedures established by sector-specific regulatory bodies, and in default, by the Institution itself applying similar principles of 'economic regulation';

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(e) A separate chapter on Ancillary Income (third party income or income from non-core services) is added;

(f) Compensation on termination is linked with the market or revenue risk being assumed by the Private Party; the actual cash flows in a test period replace the base case cash flows stated in the Financial Model agreed at the time of signing of the PPP Agreement;

(g) Upon Institution step-in caused by a breach of its obligations by the Private Party, the Institution is not required to make any payments for Services becoming unavailable because of the breach; and

(h) The Institution's share of 50% of the Refinancing Gains is passed on the end users through reduction in User Charges; the option under the Unitary Payment Standardisation for the Institution to receive its 50% share of the Refinancing Gain is eliminated.

(B) Assumptions

(B1) Given the complexities associated with trying to achieve these objectives across a wide range of diverse sectors, each with different funding requirements for service delivery, a number of assumptions have been made in this Standardisation. These assumptions are that:

(B1.1) the "Private Party" – (being the private entity responsible for the design, procurement, financing, construction and operation of the PPP Project, and referred to in this Standardisation as the "**Private Party**") to a PPP Agreement is a special-purpose vehicle ("**SPV**") incorporated in Pakistan in accordance with the Companies Ordinance, 1984, as a limited liability company for the sole purpose of exercising its rights and performing its obligations under the PPP Agreement;[4]

[4] The main justifications for ring-fencing the business of a project in such an SPV are, first, to limit primarily the lenders' and also the Institution's exposure to the risks of insolvency of the shareholders of the Private Party, secondly, to insulate a project from the risks associated with any other business (that is, non-project business) that may be carried on by the Private Party, thirdly, to

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(B1.2) the project involves the provision of public infrastructure and related services and this entails an initial design and construction phase and a later operational phase during which the required services will be delivered to the Institution or on its behalf to the end-users;

(B1.3) the project deliverables (collectively all the rights and obligations of the Private Party in relation to both phases of the project) will be subcontracted down by the Private Party to others (these subcontractors usually being the shareholders of the Private Party or parties related to them (that is, affiliated or associated companies)). These subcontracts will include a construction subcontract and an operations subcontract;

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ring-fence the cash flows and expenditure of the project from that of any other non-project business, fourthly, to simplify the monitoring of the performance of the project and, lastly, to simplify any handback of the assets of the project at the end of the term of the project.

As part of the Institution's due diligence, the Institution should request and review all documents required in terms of the Companies Ordinance, 1984, for the incorporation of the Private Party as a limited liability company including its memorandum and articles of association to ensure that all tender requirements regarding the objects, capacity, powers and capital structure of the Private Party have been complied with.

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(B1.4) the Private Party will receive a benefit for delivering the services to the end-users in the form of User Charges paid directly by the end users . Unlike Unitary Payments, User Charges may, depending on the specific Project, comprise of 'tariffs' that may vary according to the categories of end users, categories of services availed[5], or other pre-agreed criteria. However, like the Unitary Payments, User Charges are not made up of separate amounts for the various *specific inputs* that comprise the services, but mean a single or whole payment for the full service requirement (which, however, can be comprised of multiple sub-service tariffs);

(B1.4) the benefits to the Private Party may, in addition to the User Charges, also consist of Unitary Payments. This may occur in PPPs where, for instance, due to affordability concerns, the Institution agrees to supplement the revenue stream from the User Charges with Unitary Payment payable by the Institution. Such PPPs are referred to as "Hybrid PPPs". The principles stated in the Unitary Payment Standardisation will, continue to apply to the Unitary Payments. However, a 'blending' of the two approaches will be required in a Hybrid PPP[6];

(B1.5) substantial funding for the project is to be provided by limited-recourse debt to be made available by lenders (other than the shareholders or related parties of the Private Party) who will look primarily to the cash flows generated from the project (that is, the User Charges paid by the end users for the delivery of the services) to service that debt.[7] Non- or poor performance by the Private Party will result in non-charging or partial charging of the User Charges, and will put the servicing of such

[5] E.g. peak and off-peak services, firm / committed supply or interruptible supply, and the like.

[6] For instance, in relation to Compensation upon termination, the compensation payable by the Institution will not consist of two separate compensations, but one, that will be calculated with reference to the cash flows of the Project comprising of both revenue streams. See further Part N: Termination.

[7] The Lenders typically also seek security from the shareholders of the Private Party or their parent companies, though such security may not be sufficient. In such event, they may also take security over those assets acquired by the Private Party that the Institution will not require at the end of the term of the project. These assets must be clearly identified by the Institution (taking into account value for money considerations) and communicated to the bidders at the bid phase of the project. See Part G:36 (*Project Assets: Security Over Project Assets*).

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debt at risk[8]. These lenders will be able to mitigate such risk in part through step-in and substitution mechanisms provided for in terms of a direct agreement between them and the Institution;

(B1.6) the Institution will be the 'custodian' of the interests of the end-users, and will contract with the Private Party for services to be delivered direct to the end-users (see further section (D) below);

(B1.7) The Private Party will bill the end users directly, and will be primarily responsible for collection of the billed User Charges from the end users[9];

(B2) The basic contractual arrangements posed by the funding structure referred to in these assumptions are the same as for the Unitary Payment PPPs reflected in the following organogram:

[8] The Private Party is also required to provide "Performance Security" for its performance obligations. See in this regard Part F: Services (33.12: Security for Service Obligations).

[9] Though the Institution may provide support of its 'police powers' for recovery of past due User Charges from defaulting end users. See in this regard Part C: General Obligations (9.2.2.1: Institution Indemnities). However, 'Collection Services" should be distinguished from "Collection Risk".

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(B3) The above assumptions reflect the basic funding structure for projects that are funded with limited-recourse debt, that is, on a project finance basis, and are typical for projects that are highly capital intensive and therefore require funding sources with relatively low costs (compared to pure equity funding). A project finance funding structure, however, will not be appropriate for all PPPs. A different funding structure may be more appropriate in projects which are not highly capital intensive. These projects may also be funded on the balance sheet of Private Parties that are existing companies (so-called "corporate finance") or through capital contributions by Institutions and/or other public-sector bodies.

(B4) An Institution should consider all alternatives to limited-recourse debt if they achieve substantial risk transfer, meet the value for money[10] and affordability levels set for its proposed project and, in addition, if they are able to accommodate mechanisms for the ring-fencing of all cash flows from the proposed project.[11] A key feature of this risk transfer requirement is that third party funders must assume some performance risk.

(C) Other Funding Structures

[10] Institutions should note that "value for money" does not equate to the cheapest price. Risk transfer is always a fundamental consideration in the assessment of the value for money benefits of a bid. A very low bid price might well be attractive to the Institution because of its apparent affordability, however, the bid may offer low risk transfer and, therefore, not yield better value for money. Institutions should also bear in mind that apart from cost, price and risk transfer, quality and quantity are also fundamental considerations in assessing value for money.

[11] The ring-fencing of the cash flows in a project with a non-project finance funding structure is necessary to enable the Institution to monitor the cash flow of that project. This is essential in the case of revenue-generating projects.

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(C1) *Corporate Finance*

(C1.1) In a corporate finance structure, a Private Party arranges the funding necessary to meet the capital and other expenditure requirements of a project from its own balance sheet resources (or those of its shareholders and related parties). In such a structure there is no need for an SPV to ring-fence the project or for a direct agreement between the Institution and any third party funders. This type of structure can be used across all sectors in projects with capital requirements below the levels at which project finance becomes cost effective.

(C1.2) Here, third party funders are taking credit risk on the Private Party itself, as opposed to taking credit risk on the delivery of the services by the Private Party at sustained performance levels. Institutions will therefore need to conduct a comprehensive due diligence into the financial strength and creditworthiness of any bidder proposing a corporate finance structure. Having regard to the outcome of such due diligence, the required value for money and affordability levels set for the project and any capital contributions to be provided by the public-sector, an Institution may also need to consider whether or not it should require the Private Party to furnish it with any security (such as on-demand performance bonds to secure the performance obligations of the Private Party and letters of credit and/or parent company guarantees to secure the repayment of the capital contributions by the public-sector) or to maintain any credit ratings for the duration of the PPP Agreement.

(C2) *Capital Contribution by the Institution*

(C2.1) The preference is for PPP Projects to be financed by sponsors and lenders, but in limited circumstances the Institution and/or other public-sector bodies may make capital contributions required for a project. Such capital may be contributed as grants or as viability gap funding arrangements (*see para C2.3 below*), although this is not always possible

given the budgetary and regulatory framework applicable to the Institution or other public-sector bodies. It is essential that the budgetary and regulatory requirements applicable to the Institution or public-sector bodies be meticulously complied with before any commitment is made to provide capital funding of this sort. The tax implications of this funding structure must be carefully considered, particularly in relation to general sales tax or other indirect taxation ("**GST**"). Legal restrictions, if any, on the holding of shares by government entities in companies in which the private sector also holds shares must also be borne in mind when deciding how to structure these capital contributions.

(C2.2) The provision of these capital contributions by Institutions and/or other public-sector bodies obviously affects the allocation of risk. This funding structure should only be used where the funds concerned are to be applied by the Private Party in the provision of assets (movable and/or immovable) for the project that will either immediately or on termination of the PPP Agreement become the property of the Institution or other public sector body. How this will be achieved must therefore also be carefully analysed and provided for. Again, the GST and other tax consequences of any such transfer must be taken into account. The assets so provided can clearly never be available to secure obligations of the Private Party to any third party creditors (including its funders). These assets must also be fully "ring-fenced" so that even if they are not made available formally as security to third party creditors, they should also not be capable of being attached by such creditors in any circumstances. The use of this funding mechanism must not result in inappropriate risk being retained by, or passed back to, the Institution or other public-sector bodies.

(C 2.3) *Viability Gap Funding*

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Viability Gap Funding ("**VGF**") may be provided by the Institution or the Government for PPP projects that pass the test of economic viability but fail the financial feasibility test. Projects that qualify the eligibility criteria for VGF (as laid down in the relevant guidelines or policy documents) will receive capital contributions from the viability gap fund to make the project output affordable for the Institution or the end-users. The disbursement of VGF should follow identified project milestones behind agreed levels of disbursements of debt by lenders and equity by the Sponsors.

The provisions for inclusion in the PPP Agreement that are required where VGF is provided will follow in due course under 'practice notes' issued by the Approving Authority.

(C 2.4) *Credit enhancement by the Government*

The Standardisation postulates that guarantees by the Government for the performance by the Institution of its obligations under the PPP Agreement shall be eschewed. However, in extreme cases, Government guarantees may be unavoidable and may then be provided under and in accordance with the appropriate Regulatory Instruments or other guidelines that regulate provision of Government guarantees for PPP projects. In any case, the Government ought not to become a direct contracting party to the PPP Agreement; any credit enhancement or risk mitigation provided by the Government ought to be under a separate guarantee or like instrument.

The provisions for inclusion in the PPP Agreement that are required where Government guarantee is provided will follow in due course under 'practice notes' issued by the Approving Authority.

(D) Types of PPPs

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This Standardisation applies only to those types of PPPs (a) which will be subject to the Regulatory Instruments, or (b) pending the promulgation of the Regulatory Instruments, which entail direct or indirect, actual or contingent financial exposure of the Federal Government. The indirect or contingent financial exposure of the Federal Government continues to arise in User Pay PPPs because of the compensation obligations of the Institution upon the occurrence of "Compensation Events" and because of the obligation of the Institution to pay compensation to the Private Party upon early termination of the PPP Agreement. Such compensation obligations of necessity have to be assumed by the Institution, as the end users do not form a cohesive or structured body of contracting parties with the 'credit standing' necessary to back-stop large capital commitments by the sponsors and lenders for PPP Projects. The Institution acts a 'surrogate' for a diffuse mass of end users, and in that sense assumes certain obligations and enjoys certain rights under the PPP Agreement; primarily it acts as the 'custodian' of the interests of the end users and thereby performs the related 'institutional function' in the public interest that is by law or executive order decreed upon it to perform. The PPP definition in the Regulatory Instruments is expected to distinguish between two[12] basic kinds of PPP, one involving the performance by a Private Party of an "institutional function" and the other involving some form of "use of state property" by a Private Party for its own commercial purposes.

(D1) *Performance of an Institutional Function*

(D1.1) As regards the first type of PPP, the concept of "institutional function" is treated broadly as a service, task, assignment or other function (or any part or component thereof) that an Institution performs in the public interest or on behalf of the public service generally, or any service, task, assignment or other function performed in support thereof. This may include any service, task, assignment or other function that is included in the functional areas of competence assigned to the Institution in terms of the *Constitution of the Islamic Republic of Pakistan* 1973 (the

[12] A project may be a hybrid and involve both kinds of PPP.

"**Constitution**"), or any other service, task, assignment or function assigned to an Institution by legislation or executive action by the Government. It is key to note that this Standardisation does not provide guidance as to whether or not a particular institutional function resides with any one institution, as opposed to another.[13] This must be determined on a project-by-project basis at the feasibility study phase of each proposed PPP.[14]

(D1.2) Furthermore, Institutions should bear in mind that references in this Standardisation to institutional functions being performed by a Private Party pursuant to a PPP Agreement does *not* mean that an Institution may outsource *any* of its institutional functions to the private sector. This is because certain institutional functions are reserved under applicable law for performance only by the Institutions concerned and may not be outsourced to the private sector. This Standardisation does not provide guidance regarding the lawfulness of any outsourcing proposed by an Institution.

(D1.3) The responsibility for determining whether an institutional function resides with an Institution and whether that institutional function may be outsourced to the private sector pursuant to a PPP lies with the Institution proposing the PPP. In this regard, the Institution must take due cognisance of the requirements of its governing legislation and any other applicable law . The Institution must obtain legal opinion on the extent to which a Private Party can legally perform the required institutional function in terms of a PPP Agreement.[15]

(D1.4) It should also be noted that this Standardisation does not prescribe that PPPs may be used to limit an Institution's responsibilities in performing

[13] A key indicator of the competency of the Institution to perform an institutional function is the allocation of the budget for that function to the Institution since the budgetary allocation follows function.

[14] The Regulatory Instruments will likely entail a Approving Authority's Approval for the feasibility study.

[15] This is expected to be dealt with in greater detail in the Regulatory Instruments.

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its institutional functions efficiently and in a manner which demonstrates its accountability for such performance, or that PPPs are the sole or preferred option for the performance by an Institution of its institutional functions. This means that, notwithstanding the delegation pursuant to a PPP Agreement of any institutional function by the Institution to a Private Party, the Institution remains accountable for the efficient delivery of such function.[16]

(D1.5) A PPP for the performance of an institutional function entails "*output*"-based procurement, pursuant to which an Institution procures the performance and delivery of an institutional function on its behalf by a Private Party where such performance and delivery are subject to specified "*outcomes*" or "*targets*" such as quality, efficiency and quantity. This is in contrast to "*input*"-based procurement where an institution is procuring goods, assets and/or services from a private sector party that will enable the institution itself to perform and deliver its institutional functions. In other words, PPPs exclude conventional procurement transactions such as the procurement of civil works construction, agreements for the supply of goods and agreements for the provision of services by the private sector not amounting to the performance of an institutional function. In these conventional procurement transactions, the institution performs its institutional functions while the private sector party's performance obligations in relation to any such institutional functions are purely input driven, that is, to supply the inputs required for the continued performance by such institution of its institutional functions. The significance of this distinction turns on the extent of the allocation of the risks associated with the procurement in question between the institution and the private sector party. In PPP procurement, the Institution seeks substantial transfer of the risks associated with the

[16] The general legal position – expected to be reinforced in the Regulatory Instruments – remains that PPP agreements involving the performance of an institutional function will not divest the accounting officer or accounting authority of the Institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed.

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inputs used in the performance of the institutional function to the extent that such risk transfer achieves better value for money for the Institution;[17] whereas conventional procurement does not entail substantial risk transfer to the private sector and is governed by general procurement legislation.[18]

(D2) *Use of State Property*[19]

(D2.1) Subject to any contrary requirements in the Regulatory Instruments, references to "state property" or "public property" in this Standardisation are to be understood broadly to include all movable and immovable property belonging to the Federal Government, the Provincial Government, Local Governments, statutory bodies corporate, companies owned by any of the foregoing, or such property the ownership and control of which rests in any body that will in common parlance be treated as a public sector body, and include intellectual property rights. In its broadest form, the term "use" in relation to property may include a variety of use forms recognised (or not prohibited) in our law including, without limitation, those arising under a contract of "lease" or a contract of "concession".[20]

(D2.2) Since the legal consequences of the nature of various types of use vary substantially, legal advice should be sought regarding the type of legal arrangement that best fits the nature of the use rights that an Institution wishes to contract out to a Private Party in a PPP Agreement. This should be established at the feasibility study phase.[21] This Standardisation does

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17 The Regulatory Instruments will provide direction in this regard.

18 At the national level, conventional procurement is governed by the Public Procurement Regulatory Authority Ordinance and the Rules made thereunder. At the provincial level, conventional procurement is governed by their respective procurement manuals. Recently, Local Government organisations have commenced work on preparing their respective procurement manuals that in some cases include PPP procurement methods.

19 In PPPs involving the use of state or public property for the Private Party's own commercial purposes and where the Private Party will not be performing an institutional function on behalf of the Institution, the risk transfer requirement may be even greater than that for PPPs involving the performance of an institutional function (for instance, all planning risks and environmental risks will be for the Private Party and the Institution will not share in these risks as provided for in this Standardisation). Accordingly, an Institution wishing to enter into such a PPP should not assume that any risks identified in this Standardisation as being allocated to Institutions should always be assumed by it in such a PPP and should undertake a thorough assessment of these risks in the specific context of such PPP.

20 For a discussion on the distinctions between leases and concessions, see Part D (*Project Site*).

21 Which is expected to require a Approving Authority Approval under the Regulatory Instruments.

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not reflect a preference for any one use-type over another. Rather, this should be established on a project-by-project basis. Institutions should also bear in mind that a PPP will not limit an Institution's responsibility for ensuring that the state or public property is not abused or neglected.[22]

(E) Implementation[23]

(E1) As stated in the Introduction, this Standardisation does not seek to prescribe a standardised approach to every issue arising in PPPs across all sectors and projects to the extent that any sector-specific requirements or project-specific circumstances justify specific treatment. This Standardisation expressly identifies circumstances where the approach taken in relation to an issue is not prescribed, but recommended or suggested (based on value for money considerations). In these circumstances, the Parties may deviate from the recommended or suggested approach to the extent that such deviation ensures value for money for the Institution.

(E2) In all circumstances where deviations from the standardised treatment of issues are not expressly permitted in this Standardisation, an Institution seeking to deviate from any such standardised treatment must identify any such deviations and explain its reasons for such deviations in its application to the Approving Authority for the requisite Approving Authority Approval, which must be obtained before the proposed PPP Agreement is attached to the Request for Proposals ("**RFP**") for the procurement of that PPP and put out to tender.

(E3) This Standardisation also sets forth standard clauses and definitions that relate to those issues for which there ought to be standardised treatment (unless, in relation to any particular standard clause or definition, the contrary is expressly stated). These standard clauses and definitions should be included (where appropriate) in all PPP Agreements without any substantive amendment. An

[22] The Rules of Business of the Federal Government and the Provincial Governments in respect of their respective Divisions make the 'principal accounting officers' responsible for the affairs of the respective Divisions. Penal laws govern the misuse of public property in other cases, including by public officers.

[23] The implementation cycle of a PPP project is expected to be covered under the Regulatory Instruments.

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Institution that wishes to deviate from any of the standard clauses and definitions in the proposed PPP Agreement must identify these deviations and explain its reasons for them in its application for the corresponding Approving Authority's Approval. This Standardisation does not set forth standard clauses and definitions for certain issues addressed herein. Where these issues arise in a PPP, the Institution should ensure that the proposed PPP Agreement submitted for the Approving Authority's Approval includes clauses and definitions that cover these issues and that these clauses and definitions are consistent with the approach to these issues as prescribed herein, unless the Institution wishes to deviate from the prescribed approach and such deviations are identified and explained as described above.

(E4) Bidders who seek to deviate from the prescribed treatment of issues as set out in the RFP and the proposed PPP Agreement attached thereto should be required to clearly mark their proposed deviations on the proposed PPP Agreement and to explain in their bid documents their reasons for such deviations and the impact of such deviations on their bid prices.

(E5) Any substantive amendments to any standard clauses and definitions incorporated in a PPP Agreement for which the corresponding Approving Authority's Approval has already been granted will require written approval from the Approving Authority.

(F) Timing

(F1) This issue of the Standardisation must be complied with by all Institutions that seek to implement a PPP Agreement (a) which will be subject to the Regulatory Instruments, or (b) pending the promulgation of the Regulatory Instruments, which entails direct or indirect, actual or contingent financial exposure of the Federal Government and which will be put to tender after [].

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(G) Terminology

Unless the context requires otherwise, all terms used in this Standardisation that will be defined in the Regulatory Instruments shall have the meanings as defined therein.

(H) Acknowledgements

- Acknowledgment to South African National Treasury
- The World Bank (with specific reference to paper number 399 on concession designs).
- Asian Development Bank
- Review Group
- Partnerships UK
- Task Force / Working Group Members

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GLOSSARY

The following acronyms are used in this Standardisation:

EIA Environmental Impact Assessment

FRDA Fiscal Responsibility and Debt Limitation Act, 2005

GST General sales tax (and for the purposes of this Standardisation, includes other forms of indirect taxation levied on the value of sale or supply of services or goods)

IPDF Infrastructure Project Development Facility, the Public Private Partnership Unit of the Approving Authority

IRR Internal Rate of Return

KIBOR Karachi Inter-bank Offered Rate

NPV Net Present Value

PEPA Pakistan Environmental Protection Act, 1997

PPP Public Private Partnership (as used in this User Pay Standardisation, means a PPP where the benefits to the Private Party consist primarily of User Charges (though an additional revenue stream may comprise of Unitary Payment payable by the Institution in hybrid PPPs)

RFP Request for Proposals

RFQ Request for Pre-qualifications

SPV Special Purpose Vehicle

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User Charges The charges payable by end users for using the Services generated by the PPP Project (references to the term "**tariff**" in this Standardisation mean User Charges)

VGF Viability Gap Funding

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PART A: PRELIMINARY

1 DEFINITIONS

The following definitions are used in this Standardisation, unless otherwise stated, and should, where appropriate, be incorporated in the definitions clause of the PPP Agreement.

Standard Definitions

Definitions

In this PPP Agreement, unless the context otherwise requires, the following capitalised terms shall have the meanings assigned to them below and cognate expressions shall have corresponding meanings:

"Affiliate"	*any person that directly or indirectly through any one or more intermediaries controls, is controlled by or is under common control with any person, where "control" means the ability to direct or cause the direction of the business affairs and management policies or practices of a person;*
"Agreed Form"	*in relation to any document not executed simultaneously with this PPP Agreement, the terms and conditions of that document have been agreed by the Parties and initialled by each of them for identification purposes on or before the Signature Date;*[24]
"Ancillary Income"	*the income of the Private Party other than User Charges [and Unitary Payment], generated by activities (or usage of Project Assets)other than the Project Deliverables, the occasion to earn which arises as a direct consequence of the Project;*

[24] It is preferable to have all the Project Documents signed simultaneously. To the extent that this is not possible, the concept of "Agreed Form" should be used.

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"Availability Certificate"	*the certificate to be issued by the Private Party certifying that the Services are available;*
"Availability Deductions"	*has the meaning set forth in Schedule [x];*[25]
"Base Case Cash Flow Estimate"	*the estimated total annualised cash flow of the Private Party for the Service Period set forth in the Financial Model;*
"Base Case Equity IRR"	*means, having regard to the base case Financial Model, the nominal post-tax internal rate of return on Equity [and Shareholder Loans] as at the Signature Date, being [x]%;*
"Business Day"	*any day except a Sunday or public holiday in Pakistan on which banks are open for normal commercial operations;*
"Capital Expenditure"	*any expenditure treated as capital expenditure under GAAP;*
"Compensation Events"	*has the meaning set forth in Clause [x];*[26]
"Completion Certificate"	*the certificate to be issued by the Independent Certifier, declaring that the Works have been completed, in accordance with Clause [x];*[27]
"Consents"	*all consents, permits, clearances, authorisations, approvals, rulings, exemptions, registrations, filings, decisions, licences, required to be issued by or made with any Responsible Authority in connection with the performance of any of the Project Deliverables;*[28]
"Construction Subcontract"	*the contract between the Private Party and the Construction Subcontractor in respect of the Works;*

[25] A detailed Schedule regarding the payment and collection mechanism, including all Penalty Deductions to be made from the Performance Security, must be attached to the PPP Agreement. Unlike Performance Deductions, which are deductions for poor performance, Availability Deductions relate to unavailability of the more critical aspects of Services.

[26] See Part J: (*Relief Events, Compensation Events and Force Majeure*).

[27] See Part E: (*Duration and Service Commencement*).

[28] This excludes any third party consents from non-governmental authorities.

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"Construction Subcontractor" — *[x], being the person appointed by the Private Party to undertake the Works;*[29]

"Corrupt Act" — *has the meaning set forth in Clause [x];*[30]

"CPI" — *the consumer price index published from time to time by the Federal Bureau of Statistics; provided that if:*

(a) such index ceases to be published; or

(b) the Institution and the Private Party agree (or, failing agreement, if it is determined by the Independent Expert pursuant to Clause [x] (Fast-track Dispute Resolution)) that due to a change in circumstances such index is no longer representative, then from the date when the index was last published, the Parties shall use such other index as agreed between them or, failing agreement, as determined by the [Independent Expert] as being a fair and reasonable replacement index;][31]

"Debt" — *at any date, all amounts due and payable by the Private Party that are outstanding under the Financing Agreements at that date, but excluding all default interest, breakage premiums as well as all fees, costs and expenses whatsoever in connection with any hedging arrangements entered into by the Private Party;*[32]

["Default Interest Rate" — *[x];*[33]*]*

["Default Late Payment Charge" — *[x]]*

[29] Insert the name of the applicable person. For projects that do not involve construction works (for example, some IT projects) other appropriate language should be used.

[30] See Part N:55.5 (*Termination: Termination for Corrupt Acts*).

[31] See Part H:37.2.4 (*Payment and Financial Matters*). The PPP Agreement must identify the Independent Expert who will determine the replacement index should the Parties fail to reach agreement. Refer to Part S:81.2 (*Miscellaneous: Fast-track Dispute Resolution*) for guidance on the appointment and role of Independent Experts and the manner in which the fast-track dispute resolution procedure should be conducted.

[32] This definition also excludes Shareholder Loans.

[33] This is the interest rate at which all overdue amounts under the PPP Agreement will attract interest. This will usually be the base rate for example KIBOR, plus a "punitive" margin as specified. This should be established on a project-by-project basis.

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"Distributions" means,

(a) whether in cash or in kind, any:

(i) dividend or distribution of share capital;

(ii) reduction of share capital, stated capital, any capital redemption fund or any share premium account;

(iii) cancellation, conversion, redemption or re-purchase of shares or any other variation whatsoever in share capital;

(iv) payment in respect of the Shareholder Loans (whether of principal, interest, breakage costs or otherwise); or

(v) payment, loan or other financial assistance, transfer of rights or other assets or receipt of any other benefit to the extent put in place after the Signature Date and not in the ordinary course of business, not on an arm's length basis or not otherwise on reasonable commercial terms; or

(b) release of any contingent liability of any of the Shareholders or their Affiliates in respect of their financial obligations to the Private Party and/or the Lenders (or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders). Such release shall be deemed to be a cash amount for the purpose of calculating the Refinancing Gain;

"Direct Agreement" — *the agreement so titled between the Lenders (or their nominated agent), the Private Party and the Institution concluded simultaneously herewith or in the Agreed Form;*[34]

[34] See Part O:68 (*Step-in: By the Lenders*).

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"Equity"	*the entire issued share capital of the Private Party;*[35]
"Expiry Date"	*the [x]th anniversary of the [Signature Date];*[36]
"Facilities"	*[the buildings and other facilities together with all supporting infrastructure, plant and equipment] as required to enable the Private Party to exercise its rights and perform its obligations included in the Project Deliverables;*[37]
"Final Bond"	*has the meaning set forth in Clause [x];*[38]
"Financial Model"	*the financial base case for the Project as reflected in the computer model attached to this PPP Agreement on disk as Schedule [x], which model incorporates the forecast cash flow statements of the Private Party including all expenditure, revenues, taxation and financing of the Project Deliverables together with the income statements and balance sheets for the Private Party over the Project Term, and details of all assumptions, calculations and methodology used in the compilation thereof;*[39]
"Financing Agreements"	*the agreements relating to the Debt*[40] *listed in Schedule [x] in their form as at the*

[35] This definition excludes Shareholder Loans.

[36] The preferred approach in this Standardisation entails that the PPP Agreement comes into full force and effect at the Signature Date and that its effectiveness will not be subject to the fulfilment of suspensive conditions. Accordingly, the term "effective date", to the extent that it signifies a date later than the Signature Date upon which the PPP Agreement comes into effect (pending fulfilment of suspensive conditions), is not used in this Standardisation. If having regard to the circumstances described in Part A:3 (*Preliminary: Conditions*) it is appropriate for the coming into effect of a PPP Agreement to be suspended pending the fulfilment of any suspensive conditions, then the concept of an "Effective Date", being the date when the last of the suspensive conditions has been fulfilled (or waived), may be included in the PPP Agreement and the "Project Term" will run from that date.

[37] This definition will be project-specific. The definition used here is appropriate for a hospital, head office or school accommodation project.

[38] See Part F:32.6 (*Services: Security for Final Maintenance Obligations*).

[39] See Part B:4.2 (*Project Documents and Project Deliverables: Amendments and Waivers*).

[40] In the case of the Debt, the Financing Agreements usually include a loan facility, credit or common terms agreement and security documents (such as cessions in security over the bank accounts of the Private Party).

Given the Institution's potential liability on termination of the PPP Agreement for the Debt, the Equity and the Shareholder Loans, it is essential that the Institution conducts a careful due diligence of the Financing Agreements and the Shareholders Agreement to establish the amounts comprising the Debt, the Equity and the Shareholder Loans and, in particular, to ensure that the Financing Agreements and Shareholders Agreement do not include amounts that are unusual or otherwise not market standard. In this regard, see Part B:4.3 (*Project Documents and Project Deliverables: Due Diligence*). All amounts over and above outstanding capital and interest, such as default interest and breakage (or unwinding) fees, penalties, premiums and costs,

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	Signature Date and excluding all amendments thereto not approved in advance by the Institution in accordance with Clause [x]; [41]
"Force Majeure"	*has the meaning set forth in Clause [x];*[42]
"GAAP"	*generally accepted accounting practice in Pakistan as approved from time to time by the [Institute of Chartered Accountants of Pakistan] [Securities and Exchange Commission of Pakistan];*
"GST"	*the General Sales Tax or any other value-added tax or any similar tax which is imposed in place of or in addition to the General Sales Tax ;*
"Good Industry Practice"	*applying, in relation to the manner in which the Works are performed and the Services rendered, the standards, practices, methods and procedures conforming to applicable law, and exercising that degree of skill, care, diligence, prudence and foresight that would reasonably and ordinarily be expected from a skilled and experienced person engaged in a similar type of undertaking under similar circumstances;*[43]

will have to be considered. Consideration will also have to be given to the inclusion of the cost of any interest rate hedging arrangements, where the interest rate on any financing made available for the Project is a variable rate (such as KIBOR or LIBOR).

Further, it is essential that if the PPP Agreement provides for the Institution to pay any part of the Debt following termination of the PPP Agreement, then any amount included in the Debt that an Institution is not willing to pay must be excluded, whether in the definition of "Debt" or elsewhere in the PPP Agreement. See the definition of "Debt" and footnote 32.

[41] See Part B:4.2 (*Project Documents and Project Deliverables: Amendments and Waivers*).

[42] See Part J:48 (*Relief Events, Compensation Events and Force Majeure: Force Majeure*).

[43] Good Industry Practice is a comparative measure that relates to the manner in which the Services are provided and not to the nature or scope of the Services. Depending on the project, it may be appropriate to limit Good Industry Practice to the standards used inPakistan. In other projects, it may be advisable for Good Industry Practice to be determined with reference to international standards. The Institution should generally ensure that the geographical scope of these standards is the same for other projects in the same sector. The Institution should seek specific advice on this issue from its technical advisors before the commencement of the procurement phase of the Project. To the extent that a comparison can be made against objective standards, this should be done.

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"Independent Certifier"	*the independent certifier appointed by the Parties pursuant to Clause [x]*[44] *and who is responsible for issuing the Completion Certificate declaring that the Works have been completed;*[45]
"Independent Expert"	*[x];*[46]
"Institution"	*[x];*[47]
"Institution Assets"	*any assets and rights made available by the Institution to the Private Party for use in the Project Deliverables, including the Project Site;*[48]
"Institution Default"	*has the meaning set forth in Clause [x];*[49]
"Intellectual Property"	*all intellectual property whatsoever used from time to time in connection with the Works and/or the Services whether capable of registration, registered or not;*[50]
"Lenders"	*any person providing financing to the Private Party under the Financing Agreements;*
"Licensed Intellectual Property"	*all Intellectual Property to be used under licence from any third party;*[51]

[44] See Part E: (*Duration and Service Commencement*).

[45] The role of the Independent Certifier is separate from that of the Institution's own technical advisors (who assist in the technical review of proposals during the procurement phase of a project) and also from that of the Independent Experts (who, in specified instances, are responsible for adjudicating certain disputes between the Parties – these are usually disputes relating to technical or financial issues requiring fast-track resolution, which is not always possible using the ordinary dispute resolution procedures). See Part S:81.2 (*Miscellaneous: Fast-track Dispute Resolution*). On the other hand, the Independent Certifier is responsible for certifying that the construction or development works have been completed in accordance with the PPP Agreement. See Part E:19 (*Duration and Service Commencement: Independent Certifier*).

[46] Depending on the particular project there may be a need for several Independent Experts (with expertise in different areas, such as IT, finance, civil engineering and socio-economic matters) to determine disputes arising under the PPP Agreement on a fast-track basis. The PPP Agreement should clearly stipulate for the independence of all such experts and specify which disputes are to be determined by which Independent Expert. See Part S:81.2 (*Miscellaneous: Fast-track Dispute Resolution*).

The definition must distinguish between the different Independent Experts required for a project.

[47] Insert the name of the Institution procuring the PPP.

[48] This definition anticipates that these assets may not necessarily be "owned" by the Institution itself. In this regard, see Part D: (*Project Site*).

[49] See **Error! Reference source not found.** (*Termination*).

[50] The PPP Agreement should identify all Intellectual Property (if any) belonging to the state, the Institution or other public body to be made available by the Institution to the Private Party in connection with the Project and should contain adequate protections against the forfeiture of the state's or the public body's interests in and to such Intellectual Property. See **Error! Reference source not found.** (*Intellectual Property*).

[51] As part of its due diligence, the Institution must request the Private Party to make full disclosure of all Intellectual Property to be used by the Private Party under licence from third parties. These licences must be reviewed in order to ensure that they are

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"Long Stop Date"	*[[x], being the date by which the Services must have commenced, failing which the Institution shall be entitled to terminate this PPP Agreement in accordance with the provisions in Clause [x]];*[52]
"Net Cash Flow"	*at any date:* *(a) all monetary sums of an income nature received by the Private Party at that date; plus* *(b) all amounts drawn down by the Private Party under the Financing Agreements at that date; less* *(c) all expenditure of the Private Party at that date in relation to the Project Deliverables (excluding interest);*
"Operating Expenditure"	*any expenditure treated as operating expenditure under GAAP;*
"Operations Subcontract"	*the contract between the Private Party and the Operations Subcontractor in respect of the Services;*
"Operations Subcontractor"	*[x], being the person appointed by the Private Party to perform the Services;*[53]
"Parties"	*the Private Party and the Institution;*
"Penalty Deductions"	*the Availability Deductions and the Performance Deductions;*
"Performance Deductions"	*has the meaning set forth in Schedule [x];*[54]

transferable to the Institution on termination of the PPP Agreement or directly grant the Institution adequate usage rights to continue using the Intellectual Property after the PPP Agreement terminates. If the Private Party requires the use of Intellectual Property held by the Institution under licence from a third party, the Institution should first ensure that the licence terms permit the Institution to grant such use rights. See **Error! Reference source not found.** (*Intellectual Property*).

[52] See Part N:55 (*Termination: Causes of Termination*). This is a fixed date by when the provision of the Services must commence failing which the Institution will terminate the PPP Agreement. Whether the use of a Long Stop Date is appropriate depends on the sector and on the specific circumstances of a project. In this regard, see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*). The Long Stop Date should be significantly later than the Scheduled Service Commencement Date in order to avoid hair-trigger termination.

[53] Insert the name of the applicable person.

[54] The schedule regarding the payment mechanism must include details of the deductions from the Performance Security that may be made for poor performance as well as details of the specific areas of performance. Unlike Availability Deductions, Performance Deductions do not relate to critical aspects of the Services but rather to the less critical areas and are more performance-related. See also Part H: (*Payment and Financial Matters*).

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"Performance Security"	*the irrevocable revolving standby letter of credit [in the form provided in Schedule [x]] in the sum of [PKR] posted by the Private Party on the Signature Date for [period] draws thereon by the Institution in the amount of the Penalty Deductions;*
"PPP Agreement"	*this public private partnership agreement between the Parties, being a public private partnership agreement as contemplated in [PPP Law / PPP Policy];*
"Private Party"	*[x];*[55]
"Private Party Default"	*has the meaning set forth in Clause [x];*[56]
"Project"	*[x];*[57]
"Project Assets"	*all assets as required [to design, construct, develop, install, commission, operate and/or maintain the Project including the Facilities, any books and records, any spare parts and tools], as well as the Intellectual Property and the Institution Assets, but excluding all cash;*[58]
"Project Deliverables"	*the [carrying out of the Works, the installation, commissioning, operation and maintenance of the Project Assets including the repair, renewal or replacement thereof, the management and provision of the Services] and the exercise and performance of all other rights and obligations of the Private Party under this PPP Agreement from time to time;*[59]

[55] Insert the name of the Private Party to the PPP Agreement.

[56] See **Error! Reference source not found.** (*Termination*).

[57] This term should be defined on a project-specific basis.

[58] This definition will be project-specific and thus appropriate amendments may be made. In so far as Institution Assets are included in this definition, bidders should include as part of their due diligence in the bid phase of a Project a detailed analysis of the condition, life expectancy and maintenance and replacement cycle of such equipment.

[59] This definition will be project-specific and thus appropriate amendments may be made.

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"Project Documents"	*the Financing Agreements, the Shareholders Agreement, the Subcontracts and all other contracts described in Schedule [x]*[60] *relating to the performance of the Project Deliverables, each executed by the parties thereto simultaneously with this PPP Agreement or otherwise in the Agreed Form;*
"Project Insurances"	*has the meaning set forth in Clause [x] (Insurance);*[61]
"Project Officer"	*the official designated by the [accounting officer/accounting authority] of the Institution on notice to the Private Party as the project officer for the Project. The Institution may replace the project officer from time to time on prior written notice to the Private Party;*[62]
"Project Site"	*the [land made available by the Institution to the Private Party] for the conduct of the Project Deliverables as further described in Schedule [x];*[63]
"Project Site Agreement"	*the agreement between the Parties in connection with the Project Site attached hereto as Schedule [x];*
"Project Term"	*the period from the [Signature Date]*[64] *to the Expiry Date or the Termination Date, whichever occurs first;*

[60] These will include the contracts appointing any Independent Experts and any other subcontractors appointed directly by the Private Party (so-called "first-tier" subcontractors) but not the subcontracts between these first-tier subcontractors and their subcontractors (so-called "second-tier" subcontractors).

The Private Party should be obliged under the PPP Agreement to identify all Project Documents which are necessary for it to be able to perform the Project Deliverables. The list should (in this sense) be a "closed list".

[61] See Part I:40 (*Insurance: Insurance Requirements*).

[62] The appointment of project officers for projects will likely be prescribed by the Regulatory Instruments.

[63] This definition applies to infrastructure projects for the construction of Facilities where the state usually owns the land on which the Facilities are to be constructed. It does not presume, however, that the Institution that is procuring the Project Deliverables will itself own the land. For instance, the land could be owned by another organ of state and leased or otherwise made available to the Institution. If an Institution intends to use land falling under the control of another institution, then the Institution should resolve all inter-governmental matters regarding the control of the land in question before its application for the corresponding Approvals of the Approving Authority. In this regard, see Part D: (*Project Site*).

Since the definition of "Project Site" is project-specific, appropriate amendments will have to be made.

[64] If having regard to the circumstances described in Part A:3 (*Preliminary: Conditions*) it is appropriate for the coming into effect of the PPP Agreement to be suspended pending the fulfilment of any conditions, then the Project Term will run from the effective date of the PPP Agreement (being the date when the last of the suspensive conditions has been fulfilled (or waived)), and not the Signature Date.

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"Refinancing"	*has the meaning set forth in Clause [x];*[65]
"Relief Event"	*has the meaning assigned thereto in Clause [x];*[66]
"Responsible Authority"	*any ministry, any minister, any organ of state, any official in the public administration or any other governmental or regulatory department, commission, institution, entity, service utility, board, agency, instrumentality or authority (in each case, whether national, provincial or municipal) or any court, each having jurisdiction over the matter in question, but excluding for all purposes the Institution;*
"Revised Cash Flow Estimate"	*as on the Termination Date, the total forecast cash flow for the balance of the Service Period, determined by (i) taking the average of the annual cash flows shown in the audited financial statements of the Private Party for the three (3) years preceding the Terminate Date (and if less than three (3) years have passed since the Service Commencement Date, then for the actual period), and (ii) assuming such average annual cash flow to remain constant for the remainder years in the Service Period*
"Revised Forecast Equity IRR"	*as on the Termination Date, the forecast internal rate of return on Equity [and the Shareholder Loans] for the balance of the Service Period, determined by replacing the Base Case Cash Flow Estimate for such remaining Service Period with the Revised Cash Flow Estimate in the base case Financial Model, less any Distributions made or forecast to be made;*
"Scheduled Service Commencement Date"	*the date stipulated in the Works programme as the day after the date on which the*

65 See **Error! Reference source not found.** (*Refinancing*).

66 See Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*).

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	Availability Certificate is scheduled to be issued and the Services are due to commence;
"Service Commencement"	*the actual commencement of the Services, subsequent to the issue of the Availability Certificate in accordance with Clause [x];*[67]
"Service Commencement Date"	*the date of Service Commencement as stated in the Availability Certificate issued by the Private Party in accordance with Clause [x];*[68]
"Service Period"	*the period from the Service Commencement Date to the Expiry Date, unless this PPP Agreement is terminated earlier in accordance with its terms;*
"Services"	*the operational services to be provided by or on behalf of the Private Party for the end users [and the Institution] as set forth in Schedule [x], as may be subsequently amended in accordance with this PPP Agreement;*[69]
"Shareholder Loans"	*at any date, in relation to any financing (other than the Equity and the financing under a Financing Agreement) made available for the Project by the Shareholders, all principal unpaid at that date;*
"Shareholders"	*the holders of the Equity;*

[67] See Part E: (*Duration and Service Commencement*).

[68] See Part E: (*Duration and Service Commencement*). This date is critical for the purposes of establishing the commencement of payment of the User Charges, the duration of the Service Period and the implications of early or late Service Commencement.

This Standardisation assumes that there is a single Service Commencement Date, but this may not always be appropriate. In some projects, in particular, toll road projects, the commencement of the Services may occur in phases as different sections of the road are commissioned at different times.

Ideally, the Institution should not allow opening the Facilities for use by end users prior to the issuing of the Availability Certificate. To the extent that this is unavoidable, the PPP Agreement should clearly stipulate that such use should not be deemed to constitute "acceptance" by the Institution nor should it relieve the Private Party from its obligations to satisfactorily complete the Works.

[69] This refers to the operating rights and obligations of the Private Party to be delivered during the Service Period. The specific nature of the Services required is project-specific. The definition must be as inclusive as possible and cover all elements of the scope and nature of the Services to be provided.

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"Shareholders Agreement" — *the agreement(s) between the Shareholders and/or the Private Party in respect of the Equity and/or Shareholder Loans;*[70]

"Signature Date" — *the date of signature of this PPP Agreement by the last signing Party;*

"Subcontracts" — *the Construction Subcontract and the Operations Subcontract;*[71]

"Subcontractor Costs" — *all damages, losses, liabilities, costs, and expenses (including legal costs and expenses) ("Losses") that have been or will be reasonably and properly incurred by the Private Party as a direct result of the termination of this PPP Agreement, but only to the extent that:*

(a) the Losses are incurred in connection with the provision of Services or the completion of the Works by the Subcontractors, including, without limitation:

(i) the cost of any materials or goods ordered or Subcontracts placed that cannot be cancelled without such Losses being incurred;

(ii) Subcontractor losses of profits for a period not exceeding [__][72]

(iii) any expenditure incurred in anticipation of the provision of the Services or the completion of Works;

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70 This definition is wide enough to include the agreements in respect of the Shareholder Loans and subscriptions for Equity, and also the agreement (if separate) governing other matters affecting the Shareholders and their relationships among each other and with the Private Party.

71 This definition is limited to the first-tier subcontractors.

72 Subcontractor Costs should be carefully calculated so as not to extend beyond first-tier subcontractors, and to include future subcontractor (first-tier only) losses of profits up to a limit to be established with reference to a specified period. In determining the period for which the Institution should compensate the Private Party for Subcontractor losses of profits, the Institution must take into account (i) the particular sector or industry; (ii) the likely waiting time before the Subcontractor will procure another project; and (iii) the expired duration of the Project Term so that the greater the unexpired portion of the Project Term, the higher the amount that the Institution should pay. Currently, losses of profits should in any event be compensated for a period of between one to five years, taking into account the above factors. As the PPP market in Pakistan develops, this time period should shorten.

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(iv) the cost of demobilisation including the cost of any relocation of equipment used in connection with the Project; and

(v) retrenchment payments; and

(b) the Losses are incurred under arrangements and/or agreements that are consistent with terms that have been entered into in the ordinary course of business and on reasonable commercial terms; and

(c) each of the Private Party and the relevant Subcontractor has used reasonable endeavours to mitigate its Losses;

"Subcontractors"	*the counter-parties of the Private Party to the Subcontracts including the Construction Subcontractor and the Operations Subcontractor;*[73]
"Termination Date"	*any date of early termination of this PPP Agreement in accordance with its terms;*
"Unforeseeable Conduct"	*has the meaning set forth in Clause [x];*[74]
["Unitary Payments"	*the charges payable to the Private Party by the Institution in connection with the performance of its obligations included in the Project Deliverables as calculated in accordance with Clause [x];*[75]*]*
"User Charges"	*the charges the Private Party is permitted to bill to [and collect from] the end users in connection with the performance of its obligations included in the Project*

73 This should only include first-tier Subcontractors and not any subcontractors of the first-tier Subcontractors.

74 See Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*).

75 See Part H: (*Payment and Financial Matters*). The consideration payable to the Private Party for the Project Deliverables may be partly in the form of unitary payments payable by the Institution in Hybrid PPPs, along with user charges collected by the Private Party that derive from the provision of the Services (for example, tolls payable by toll road users). See Part H: (*Payment and Financial Matters*). Appropriate amendments will have to be made in the PPP Agreement for Hybrid PPPs.

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	Deliverables as calculated in accordance with Clause [x];
"Variations"	*any variations to the Project Deliverables in accordance with Clause [x];*[76]
and	
"Works"	*the [design, construction, fitting, installation and commissioning] works to be undertaken by the Private Party as detailed in Schedule [x].*[77]

2 INTERPRETATION

The PPP Agreement should include provisions setting forth the agreed principles that will govern the interpretation of the language, definitions and other terms used in the PPP Agreement.

Standard Clause

Interpretation

This PPP Agreement shall be interpreted according to the following provisions, unless the context requires otherwise:

(a) References to the provisions of any law shall include such provisions as amended, re-enacted or consolidated from time to time in so far as such amendment, re-enactment or consolidation applies or is capable of applying to any transaction entered into under this PPP Agreement.

(b) References to "indexed to [CPI]" in relation to any amount of money shall mean that such amount has been expressed in [month and year in which the Signature Date[78] *occurs] prices and shall be escalated annually as at the Signature Date and each anniversary thereof with reference to the then most recent publication of the [CPI], subject to adjustments for any rebasing or recalculation thereof in accordance with the formula contained in Schedule [x].*

[76] See Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*).

[77] A detailed Schedule setting out the scope and standards of the construction (or development) works must be prepared and attached to the PPP Agreement.

[78] In some cases this may be the Effective Date. See discussion under Part A:3 (*Preliminary:Conditions*)

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(c) References to "Parties" shall include the Parties' respective successors-in-title and, if permitted in this PPP Agreement, their respective cessionaries and assignees.

(d) References to a "person" shall include an individual, firm, company, corporation, juristic person, Responsible Authority, and any trust, organisation, association or partnership, whether or not having separate legal personality.

(e) References to any "Responsible Authority" or any public or professional organisation shall include a reference to any of its successors or any organisation or entity, which takes over its functions or responsibilities.

(f) References to "Clauses", "sub-Clauses" and "Schedules" are references to the clauses, sub-clauses and schedules of this PPP Agreement.

(g) The headings of Clauses, sub-Clauses and Schedules are included for convenience only and shall not affect the interpretation of this PPP Agreement.

(h) The Schedules to this PPP Agreement are an integral part of this PPP Agreement and references to this PPP Agreement shall include the Schedules.[79]

(i) The Parties acknowledge that each of them has had the opportunity to take legal advice concerning this PPP Agreement, and agree that no provision or word used in this PPP Agreement shall be interpreted to the disadvantage of either Party because that Party was responsible for or participated in the preparation or drafting of this PPP Agreement or any part of it.

(j) Words importing the singular number shall include the plural and vice versa, and words importing either gender or the neuter shall include both genders and the neuter.

(k) References to "this PPP Agreement" shall include this PPP Agreement as amended, varied, novated or substituted in writing from time to time.

(l) References to any other contract or document shall include (subject to all approvals required to be given pursuant to this PPP Agreement for any amendment or variation to or novation or substitution of such contract or document) a reference to that contract or document as amended, varied, novated or substituted from time to time.

(m) General words preceded or followed by words such as "other" or "including" or "particularly" shall not be given a restrictive meaning because they are preceded or followed by particular examples intended to fall within the meaning of the general words.

[79] See Part B:5 (*Project Documents and Project Deliverables: Schedules*).

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3 CONDITIONS

3.1 This Standardisation assumes that the Signature Date and the date when the PPP Agreement comes into full force and effect will be the same. In other words, it assumes that the coming into effect of the PPP Agreement will not be suspended pending the fulfilment of conditions (so-called "suspensive conditions" or "conditions precedent"). It further assumes that where the Signature Date and the effective date correspond, the continued effectiveness of the PPP Agreement will not be set aside following the occurrence or non-occurrence of future conditions (so-called "resolutive conditions" or "conditions subsequent").[80]

3.2 This approach minimises the risk that the PPP Agreement will fail for non-fulfilment of conditions that could be managed otherwise by the Parties, for instance, by other mechanisms in the PPP Agreement such as an extension of time and/or compensation. However, depending on the particular circumstances of each PPP and the nature of the condition, this approach might not always be appropriate. Thus if this approach is not legally possible or it creates any material practical difficulties and better value for money can be achieved for the Institution by it agreeing that certain conditions will suspend the enforceability (or terminate the continued enforceability) of the PPP Agreement, then the Institution may depart from this approach and agree to the inclusion of conditions in the PPP Agreement.[81]

3.3 Typically, conditions entail the obtaining of third party Consents required for the performance of the Project Deliverables. At the commencement of the

[80] The Lenders will generally require that their obligations to advance, from time to time, any funding under the Financing Agreements be subject to the fulfilment of several suspensive conditions including the obtaining of all Consents required for the commencement of the construction Works, for example, environmental Consents such as a record of decision approving any environmental impact assessment ("**EIA**") as may be required under applicable environmental law. This should not, however, affect the Institution's determination of what (if any) suspensive conditions may be appropriate to suspend the coming into effect (as between the Institution and the Private Party) of the PPP Agreement. Since the Debt funding will not be available for drawing by the Private Party until the conditions to drawing under the Financing Agreements have been fulfilled (or waived), the availability of the Equity funding and Shareholder Loans will be critical in the early mobilisation phase of a Project.

[81] See Section 3.8, but compare Sections 3.4 to 3.7. All conditions must be clearly identified and explained by the Institution in its applications for the corresponding Approvals of the Approving Authority. .

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PPP negotiations, the Institution and the Private Party should identify:

3.3.1 all Consents required for the Project;

3.3.2 the Party responsible for obtaining each Consent;

3.3.3 the earliest practical date by when each Consent can be obtained;

3.3.4 whether the obtaining of any Consent that can only be obtained after the anticipated Signature Date should be treated as a suspensive condition or whether the failure to obtain such Consent should be treated as a resolutive condition.

While this process of identifying all required Consents should as far as possible be an interactive one, the PPP Agreement should reflect that the Private Party ultimately bears the responsibility (as between the Parties) for *identifying* all Consents that are required by it (or the Subcontractors) to perform the Project Deliverables.

The prescribed approach for User Pay PPPs is that the signing of the PPP Agreement should, barring exceptional circumstances, be done only after the tariff for the Project is agreed *and allowed* by the Responsible Authority. The initial setting of the tariff should not be a Consent to the effectiveness of the PPP Agreement. However, where the Project structure requires subsequent resetting of the tariff, such resetting, *within the parameters agreed in the PPP Agreement*, may be made a Consent. Further discussion in relation initial tariff setting and subsequent adjustments during the Project Term is set forth in Part H: Payment and Financial Matters (Section 37: User Charges).

3.4 Any Consents that are required to give either Party the necessary authority and power to sign the PPP Agreement should be obtained by the Party concerned before the signature of the PPP Agreement and should *not* be treated as

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suspensive or resolutive conditions. (This also applies to any approvals that may be required pursuant to the Regulatory Instruments from the Approving Authority.[82]) It also applies to all corporate approvals (that is, all resolutions of the board of directors and the shareholders of the Private Party) required for the incorporation of the Private Party and to authorise the execution of the PPP Agreement by its representatives and its performances thereunder, as well as to all related regulatory approvals and filings required under the Companies Ordinance, 1984 in connection with the incorporation of the Private Party. It is *not* appropriate for the PPP Agreement's enforceability to be suspended pending the incorporation of the Private Party and the taking of all corporate action necessary to authorise the execution and performance of the PPP Agreement.[83]

3.5 In PPPs for the performance of an institutional function, any Consents relating to the appropriate zoning or re-zoning of, and any appropriate land-use Consents required to permit the conduct of the Project Deliverables at, the Project Site should be the responsibility of the Institution, which must obtain these Consents well before the signing of the PPP Agreement (at the feasibility study phase). The same principle applies to any macro-level environmental assessment or report required pursuant to PEPA in relation to any such PPP.[84] The obtaining of these Consents should *not* be treated as a condition for the enforceability (or continued enforceability) of the PPP Agreement.

3.6 The obtaining of any Consents relating to the design, construction, engineering, technical and installation specifications put forward by the

[82] It should be borne in mind that the Approval process expected to be provided for in the Regulatory Instruments will not obviate other necessary approvals. As indicated elsewhere in this Standardisation, at the feasibility study stage of a PPP, the accounting officer or accounting authority, as the case may be, of the Institution must identify the extent to which the institutional function or use of state/public property can legally be performed by a Private Party in terms of a PPP Agreement. This should entail, among other things, the identification of all necessary Consents.

[83] If any of the Shareholders of the Private Party are non-residents, any exchange control Consent required by them should be obtained by the Signature Date. The Institution should not agree that the obtaining of these Consents be a suspensive condition of the PPP Agreement.

[84] See Part D:13 (*Project Site: Planning Consents and Risks*) and Part D:14 (*Project Site: Environmental Consents and Risks*).

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Private Party (such as, any building Consent and any record of decision regarding any EIA required for the Works) should be the responsibility of the Private Party and should not be treated as suspensive conditions. This is because the Private Party bears the design and construction risks in the Project and, therefore, it should also assume the responsibility for identifying and obtaining all design and construction-related Consents, otherwise these risks will be transferred back to the Institution.[85] Accordingly, the Private Party should be required to allocate adequate time in its Works programme for the obtaining of all such Consents. Delays in the obtaining of such Consents should not delay the coming into effect of the PPP Agreement, but may instead be dealt with through alternative mechanisms (such as Relief Events) to the extent that such delays are not attributable to any fault on the part of the Private Party or its Subcontractors.[86]

3.7 In similar vein, other Consents relating to corporate and commercial organisation of the Private Party should be obtained before the Signature Date and should not be treated as resolutive conditions.

3.8 Depending on the nature of the project, other Consents or actions may be required from, among others, sector-specific regulators to permit the Private Party (or the Subcontractors) to undertake aspects of the Project Deliverables. The timing of any sector-specific Consent or action will usually depend on the requirements of the legislation applicable to the sector concerned.[87] In some instances, such Consents may only be granted after a Private Party has already undertaken certain activities contemplated in a PPP Agreement. If any sector-specific legislation only allows for a Consent to be granted or action taken by the relevant regulator after certain activities contemplated in the

[85] The Institution should, however, provide any reasonable assistance to the Private Party in this regard.

[86] See Part D:13 (*Project Site: Planning Consents and Risks*), Part D:14 (*Project Site: Environmental Consents and Risks*) and Part J: (*Relief Events, Compensation Events and Force Majeure*).

[87] For example, under the regime applicable for private power generation, the execution of the power purchase agreement between the purchaser and the IPP depends on generation licence having been obtained first by the IPP.

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PPP Agreement have been completed, then it may be appropriate to deal with these Consents or actions as conditions precedent.

3.9 Any conditions agreed to by the Institution must be carefully drafted so as to ensure that the Institution does not inadvertently take back risks that have been allocated to the Private Party. In addition, the Institution should consider requiring the Private Party or its funders to furnish security to the Institution to cover the Institution's wasted costs if such conditions are not fulfilled because of the failure on the part of the Private Party to use all reasonable efforts to ensure that such conditions are fulfilled.[88]

[88] See Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) for a discussion on various kinds of security.

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PART B: PROJECT DOCUMENTS AND PROJECT DELIVERABLES

4 PROJECT DOCUMENTS

4.1 Introduction

4.1.1 The Private Party should be obliged as a term of the PPP Agreement to identify all Project Documents (in a Schedule to the PPP Agreement) that are necessary for it to be able to perform the Project Deliverables.[89]

4.1.2 The Institution must review and be satisfied with the terms and conditions of the final execution form of each Project Document, and the Parties should endeavour to ensure that each Project Document is executed simultaneously with the PPP Agreement. If this is not practical, then the Institution should ensure that any Project Document not executed at the signing of the PPP Agreement is in final Agreed Form by the Signature Date. This is typically done by the Parties initialling each page of the final Agreed Form (for identification purposes) and agreeing that the Institution will have the right to agree to all amendments to the final Agreed Form.

4.2 Amendments and Waivers

4.2.1 Generally, any amendments to, or waivers of any rights under, any Project Document to which the Institution is not a party must be subject to prior notice to, and the written agreement of, the Institution.[90] The Institution's consent should be withheld only where it reasonably considers the performance of the Services could be adversely affected by such amendment. No amendment may be made without the Institution's

[89] The Project Documents typically include the Subcontracts, the agreements for the appointment of the Independent Certifier and any Independent Experts, the Financing Agreements, the Shareholders Agreement and the Project Site Agreement.

[90] If the Institution is a direct party to a Project Document or is expressly entitled to accept any rights arising under it for its own direct benefit (by way of a so-called "*stipulatio alteri*" or "stipulation in favour of another"), which may be the case in relation to agreement(s) for the appointment of any Independent Expert(s), then there will be no need to provide for a specific right in the PPP Agreement for the Institution to limit the ability of the Private Party to agree on changes to any such Project Document since the Private Party would in any event not be able to do so without involving the Institution.

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consent which the Institution may decline in its discretion if the effect thereof is to increase the compensation obligation of the Institution upon termination. The only exception to this is for Exempt Refinancings, where notification to the Institution is required but the agreement of the Institution is not.

4.2.2 The Institution should not agree to any amendment of, or waiver of any rights under, any Project Document if such amendment or waiver may impact negatively on value for money, affordability or the risk profile of the Project. If such amendment or waiver also entails an amendment to the PPP Agreement itself that may be material, then the Institution may not agree to such amendment without the prior written approval of the Approving Authority. Such approval will only be given if the PPP Agreement, as amended, will continue to provide value for money, be affordable for the end-users and, for Hybrid PPPs, also the Institution and transfer substantial risk to the Private Party.[91]

Standard Clause

Project Documents

(a) The Private Party must comply with the provisions of the Project Documents and, save as otherwise provided in relation to Exempt Refinancings or [Permitted Borrowings], may only:

(i) terminate, or make any amendment to (or otherwise agree to do so) any Project Document; or

(ii) in any respect, depart from its obligations or waive any rights under any Project Document,

with the prior written agreement of the Institution.[92]

[91] These principles are expected to be dealt with in the Regulatory Instruments as well.

[92] The assignment by the Private Party of any of its rights and/or obligations under any Project Document without the prior agreement of the Institution is also prohibited. This is dealt with in Part S:78.1 (*Miscellaneous: Assignment*).

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(b) *The Private Party shall procure that any Project Document not executed simultaneously with this PPP Agreement is executed in the Agreed Form annexed to this PPP Agreement.*

(c) *Without limiting the restrictions on amendments to the Project Documents in Clause (a) above, the Private Party shall furnish the Institution with a true and complete copy (including all annexes) of any amendment to any Project Document or of any Project Document not executed by the Signature Date, within [x] Business Days of the date of the Private Party's execution of such amendment or Project Document.*[93]

4.3 Due Diligence

4.3.1 Introduction

Although the Institution should not seek to micro-manage the implementation of the Project by a Private Party, it must nevertheless ensure that it understands how the Private Party intends to deliver the Project Deliverables in terms of its subcontracting and financing arrangements and be satisfied that those arrangements (as reflected in the relevant Project Documents) are adequate to allow the Private Party to deliver the Project Deliverables.

4.3.1.1 Accordingly, the Institution should (through its advisors) conduct a thorough ongoing due diligence on all the proposed Project Documents at the bid evaluation phase and during the negotiations with the successful bidder until their execution. This is essential for several reasons including the following:

(a) the amount of compensation payable to the Private Party on termination may in certain circumstances (for example, an Institution Default) take into account certain amounts

[93] Any Project Documents to be executed after the Signature Date should be disclosed in the Schedule to the PPP Agreement listing the Project Documents, and should be in the Agreed Form.

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(or a portion thereof) owed by the Private Party to the Lenders under the Financing Agreements. The Institution must review the Financing Agreements to establish how these amounts are calculated;[94]

(b) the amount of compensation payable to the Private Party may in certain circumstances (for example, an Institution Default) take into account Equity and/or Shareholder Loans. If so, the Institution should review the Shareholders Agreement to establish how the amounts included in it are calculated;[95]

(c) where the Institution relies on the requirements of the Lenders under the Financing Agreements for protection in relation to certain risks (for example, in the case of maintenance risk, the Lenders' requirement for financial provisions for the ongoing maintenance of the Facilities through a maintenance reserve account or for ongoing asset replacement through an asset replacement account), the Institution should ensure that the terms of the Financing Agreements reflect the Institution's expectations;

(d) where the Institution seeks to retain the right to assume the Subcontracts in the event of the termination of the PPP Agreement, the Institution should examine the terms of the Subcontracts to ensure that they permit such assumption. This is particularly important where the

[94] See **Error! Reference source not found.** (*Termination: Compensation on Termination for Institution Default*) for a description of the circumstances when the compensation payable to the Private Party upon termination will take Debt into account.

[95] See **Error! Reference source not found.** (*Termination*).

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Institution wishes to ensure the continuity of service provision under the Subcontracts in circumstances where the PPP Agreement is terminated and these Services are critical. Adequate provision for such rights in favour of the Institution in the Subcontracts themselves will avoid the need for direct agreements between the Institution and the Subcontractors;

(e) to ensure that the Financing Agreements and Shareholders Agreement are consistent with the agreed Financial Model; and

(f) to ensure that the Financing Agreements and the Shareholders Agreement are consistent with the provisions of the PPP Agreement dealing with Refinancings.

4.3.1.2 The Institution (with the assistance of its insurance advisor) should also review:

(a) the policies relating to the Project Insurances to ensure that they are consistent with the agreed insurance requirements for the Project and that they contain no endorsements, exclusions, excesses or deductibles that are not market standard; and

(b) the letters of the broker appointed to place the agreed Project Insurances so as to ensure that the broker's undertakings referred to in **Error! Reference source not found.** (*Insurance*) are incorporated in them.

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4.3.2 Financing Agreements and Shareholders Agreement

4.3.2.1 The Institution should require copies of the Financing Agreements and the Shareholders Agreement (in final Agreed Form, as these agreements are unlikely to be executed before the Signature Date of the PPP Agreement) of the preferred bidder in advance of the Signature Date to allow it sufficient time to conduct its due diligence.

4.3.2.2 In the due diligence, the Institution should assess and seek advice from its advisors concerning, among other things:

(a) *interest margins* – in particular, whether these agreements make provision for changes in the margins on interest rates. Any changes in the margins should be consistent with those contemplated in the Financial Model;

(b) *fees and costs* – any (i) breakage (that is, unwinding) fees, penalties, premiums and costs for early prepayment of the Debt; (ii) costs (including related breakage costs) relating to any hedging arrangements (including, among other things, any swaps, options, floors and caps) to mitigate against interest rate and foreign exchange fluctuations; (iii) commitment, underwriting, arrangement, structuring or other fees payable to the Lenders (or to the arrangers of the financing made available to the Private Party or to the Lenders' agents). If the termination compensation will include any fee, penalty, premium or cost as contemplated above, then the Institution must seek advice as to whether it (and the amount thereof) is market standard, competitive

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and cost-effective and as to how it is calculated.[96] The Institution should also review all hedging arrangements in respect of these costs to ensure that the Private Party has adequately hedged against its exposure to any interest rate and foreign exchange fluctuations;

(c) *maintenance and other reserves* – the Lenders' requirements in respect of the funding of any cash reserves to be put in place by the Private Party (including, for example, any maintenance reserve account or asset replacement account) and the levels required to be maintained in these reserves. The Institution should confirm that upon termination of the PPP Agreement all these reserves will be applied in reduction of the amount of the Debt for the purpose of calculating the termination compensation (so that the Private Party and its funders will not obtain a double recovery) and, further, in the case of any Refinancing (other than an Exempt Refinancing) that the release of any of these reserves will be caught in the sharing mechanism;

(d) *intercreditor arrangements* – the intercreditor arrangements between the Lenders and/or the Shareholders should not undermine any principles agreed to in the PPP Agreement, particularly in relation to the PPP Agreement provisions concerning the payment and amount of any termination compensation;

[96] As regards which fees, penalties, premiums and costs may be incorporated into the termination compensation, see Part N: 59 (*Termination: Compensation on Termination for Institution Default*) and Part N:61 (*Termination: Compensation on Termination for Force Majeure*).

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(e) *letters of credit* – the Private Party's rights pursuant to the Financing Agreements to maintain reserves through the provision of letters of credit or to withdraw the proceeds of any reserve accounts and replace them with letters of credit should be considered. The Institution must ensure that (i) the benefits of any such letters of credit are taken into account in the calculation of any termination compensation and in the sharing of any gains deriving from any Refinancing (other than an Exempt Refinancing), (ii) the amounts capable of being claimed under any letters of credit are set off against the termination compensation to be paid by the Institution to the Private Party (so that the Private Party and its funders will not obtain a double recovery), and (iii) the letters of credit do not automatically terminate on termination of the PPP Agreement (automatic termination will result in the Institution paying a higher compensation amount). Accordingly, the Institution should require a pre-agreed form of letter of credit to be used if the Financing Agreements require reserves to be maintained through the provision of letters of credit or permit reserve accounts to be replaced with letters of credit;

(f) *Equity structure* – the shareholdings in the Private Party should be consistent with the ownership and control arrangements set out in the Private Party's bid proposal. Any security interests taken over the Equity should also be considered for their implications in relation to the change in shareholding restrictions contained in the PPP

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Agreement (see Part S:78.3 (*Miscellaneous: Changes in Shareholding and Control*)); and

(g) *Security* – it may be appropriate for the Institution to allow the Private Party to grant the Lenders security interests in certain tangible Project Assets to be furnished by the Private Party over the Project Term.[97] This will depend on whether the granting of such security interests will provide better value for money and on whether these Project Assets will be needed by the Institution for the continued availability of the Services after the end of the Project Term. The Institution must ensure that the RFP identifies all Project Assets or categories of Project Assets that the Institution will require at the end of the Project Term so that this can be taken into account by the bidders in their assessment of the security package and the calculation of their bid prices.[98] The Lenders may then be permitted to take security over the remaining Project Assets. The Institution must also ensure that the Project Documents make provision for the release of any such security when the Debt is discharged.

4.3.3 Subcontracts

4.3.3.1 Bearing in mind that the Private Party must bear the risks of subcontracting any part of the Project Deliverables and, further, that the provision of any subcontracted Services should reflect what is available in the market, the Institution should nevertheless

[97] It is generally inappropriate for the Institution to agree to grant to the Lenders or to any third parties security interests over any Institution Assets (including the Project Site) included in the Project Assets.

[98] Regulatory Instruments

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review the Subcontracts prior to the Signature Date to ensure that what the Subcontractors will provide in terms of the Subcontracts is reasonably likely to meet the output specifications of the PPP Agreement and that the price of any such Subcontract is not higher than the price for that Subcontract set forth in the Financial Model.

4.3.3.2 The Institution's main concerns in relation to the Subcontracts should be the following:

(a) *term of Operations Subcontract* – the term of this Subcontract should match the Service Period;

(b) *expertise, experience and responsibility* – since the Private Party is an SPV with no track record of service delivery, the Institution must be satisfied that each Subcontractor has the necessary expertise and experience to deliver the part of the Project Deliverables subcontracted to it.[99] The Institution must also satisfy itself that the Subcontracts are consistent with the terms proposed in the Private Party's bid proposal and the PPP Agreement, that they impose responsibility on each Subcontractor to perform its subcontracted obligations and that the Private Party has real recourse to each Subcontractor in the event that it defaults under its obligations in the Subcontract. Here, the Institution should identify any limitations in the Subcontracts on the liabilities of Subcontractors to perform their obligations in terms of the Subcontracts;

[99] The expertise and experience of the Subcontractors should be established at the bid evaluation phase and confirmed when Subcontracts are finalised.

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(c) *replacement of Subcontractors* – the Institution must reserve the right in the PPP Agreement to approve the selection of any replacement Subcontractors applying the same criteria applied in the selection of the initial Subcontractors (such as appropriate expertise, experience and responsibility);[100]

(d) *amendments to Subcontracts* – the Subcontracts should record that any amendments to those Subcontracts will require the prior written agreement of the Institution (which shall not be unreasonably withheld); and

(e) *liquidated damages* – if the PPP Agreement requires the Private Party to pay liquidated damages to the Institution for late delivery of any subcontracted Project Deliverables, then the Institution should ensure that these damages are payable out of amounts available under the relevant Subcontracts (subject to the claims of the Lenders). This is important because if the terms of the PPP Agreement and Subcontracts are materially different, then the Institution could be exposed if the Private Party cannot claim from the Subcontractor responsible for the relevant Project Deliverables.

5 SCHEDULES

5.1 PPP Agreements usually include several attachments and annexures (referred to in this Standardisation as "**Schedules**").

5.2 These typically set out:

[100] See Part S: 78.2 (*Miscellaneous: Subcontracting*).

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5.2.1 the Financial Model (usually in disk format);

5.2.2 the executed Project Documents or, if not executed by the Signature Date, the Agreed Forms of any such Project Documents;

5.2.3 the Institution's output specifications (which will have formed part of the RFP);

5.2.4 the Works programme and scope of Works;

5.2.5 the Services to be provided by or on behalf of the Private Party (where the project design is not fully worked out at the time of signing of the PPP Agreement, a 'Design Development' Schedule is also to be added that provides for milestones and targets for full development of the Design) ;

5.2.6 the Project Site description unless the description is included in a Project Site Agreement;

5.2.7 the list of any Institution Assets;

5.2.8 the performance monitoring regime;

5.2.9 the payment mechanism (where applicable, together with tariff and tariff readjustment procedure), including the definitions of "Performance Deductions" and "Availability Deductions", and the methodology for Penalty Deductions;

5.2.10 the formula for the rebasing or recalculation of CPIX;

5.2.11 the Consents relating to the Project;

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5.2.12 the list of the Project Insurances (including a statement of the material terms thereof) and the broker's letter confirming the placement of the Project Insurances;

5.2.13 the incorporation details of the Private Party (including copies of its certificate of incorporation and certificate to commence business) and its capital structure and shareholdings;

5.2.14 the prescribed form of Availability Certificate, the Completion Certificate and any other certificate provided for in the PPP Agreement;

5.2.15 the form of Direct Agreement;

5.2.16 the form of Performance Security; and

5.2.16 the handback procedure.

6 PROJECT DELIVERABLES

6.1 The scope and extent of the Project Deliverables are project-specific and will be based on the specific strategic and operational objectives which the Institution wishes to attain as reflected in its output specifications.

6.2 The approach prescribed in this Standardisation is that the Private Party shall bear all the risks associated with the performance of the Project Deliverables which the Institution does not expressly assume. This must be reflected in the PPP Agreement as an express undertaking by the Private Party to exercise its rights and perform its obligations included in the Project Deliverables at its own risk save as otherwise expressly provided in the PPP Agreement.[101]

6.3 Although the risks associated with the performance of the Project Deliverables reside with the Private Party and not the Institution (save to the extent

[101] See the Standard Clause below.

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expressly assumed by the Institution), the successful implementation of this risk allocation depends largely on the clarity of the output specifications and the Parties' co-operation in the implementation of the Project Deliverables. Accordingly, the Institution should ensure that the output specifications included in the RFP are clearly drafted and that the PPP Agreement makes provision for co-operation.

Standard Clause

Project Deliverables

(a) Private Party

(i) Subject to, and in accordance with, the provisions of this PPP Agreement, the Private Party shall exercise its rights and perform its obligations included in the Project Deliverables at its own cost and risk without recourse to the Institution save as otherwise expressly provided for in this PPP Agreement.

(ii) Without limiting Clause (i), the Private Party shall at its own cost and risk be solely responsible for procuring that the Project Deliverables are performed:

(aa) in accordance with Good Industry Practice;

(bb) in a manner that is not likely to cause death, injury to health or damage to property or the environment;

(cc) in a manner that is consistent with the Institution discharging its statutory functions and duties;[102]

(dd) in compliance with all applicable law and the Consents; and

(ee) to achieve the [output specifications] for the Project set forth in Schedule [x][103] *in accordance with this PPP Agreement.*

(b) Co-operation

[102] This is particularly important in the case of hospital projects where clinical service provision by the Institution must not be hindered or prevented by the manner of conduct of the Project Deliverables.

[103] This refers to the Institution's output specifications (which will have formed part of the RFP).

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Each Party shall co-operate with the other in the exercise and performance of their respective rights and obligations under this PPP Agreement.

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PART C: GENERAL OBLIGATIONS

7 GENERAL OBLIGATIONS AND RESPONSIBILITIES OF PRIVATE PARTY

7.1 As indicated above, it is assumed in this Standardisation that the Private Party will be an SPV and, accordingly, will not engage in any business or activities not included in the Project Deliverables. If, in a particular Project, the Private Party is entitled to engage in any non-project activities on the Project Site or to use any other Project Assets for purposes not related to the Project, then the provisions of the PPP Agreement dealing with its general obligations and responsibilities will have to be amended accordingly and, in particular, to ensure that the Project is not prejudiced (by the diversion of Project Assets or the non-availability of the Services) as a result of such non-project activities.

7.2 It is also assumed that the Private Party will subcontract the Project Deliverables to the Subcontractors.

7.3 These assumptions are reflected in the following Standard Clause.

Standard Clause

General Obligations

(a) *The Private Party shall not engage in any business or activity other than [i] the business or activity included in, or otherwise required to enable the Private Party to provide, the Project Deliverables[, and (ii) as required to generate Ancillary Income, provided that such activities shall not impact the Project Deliverables].*

(b) *The Private Party shall not be relieved of any obligation, responsibility or liability under this PPP Agreement by the appointment of any Subcontractor to carry out any part of the Project Deliverables. As between the Private Party and the Institution, the Private Party shall be responsible for the payment, performance, acts, defaults, omissions, breaches and negligence of all Subcontractors. All references in this PPP Agreement to any performance, payment, act, default, omission,*

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breach or negligence of the Private Party shall be deemed to include any of the same by a Subcontractor.[104]

8 WARRANTIES

8.1 Introduction

8.1.1 In this Standardisation, "warranty" is used to mean a statement confirming the truth of the matters mentioned in it as at the Signature Date.[105] A breach of a warranty in the PPP Agreement should not give rise to any right on the part of the defaulting Party to rescind or otherwise terminate the PPP Agreement, save in the case of warranties relating to Corrupt Acts.[106] Instead, a breach of warranty should give rise only to a claim for damages under the indemnity provisions of the PPP Agreement (within the limits referred to herein and subject to an obligation on the part of the aggrieved Party to mitigate the consequences of the breach), save in the case of a breach of the warranties relating to Corrupt Acts where termination is also permitted.[107]

8.1.2 The Private Party warranties in the Standard Clause below set out the minimum warranties that will ordinarily be sought by the Institution. The Institution should consider at the time when the RFP is being prepared and also at the bid evaluation phase whether any additional warranties should be sought. For instance, additional warranties may be required from the Private Party in connection with any Intellectual Property

[104] This Standard Clause reflects the prescribed allocation of Subcontractor risk (that is, the risk of losses or damages arising as a result of defaults on the part of any Subcontractor or its insolvency) to the Private Party. The Private Party will, in turn, pass any risks associated with the performance of any part of the Project Deliverables by any Subcontractor down to the relevant Subcontractor. For instance, in the case of any design risks or completion risks to the Construction Subcontractor and other "first-tier" construction Subcontractors (if any) such as the quantity surveyor by obtaining indemnities or some form of security such as construction guarantees or cessions in security of the proceeds of any insurance to be taken out by the Subcontractors. Notwithstanding this, prior to the Signature Date the Institution should satisfy itself following a review of the Subcontracts that the subcontractor risks are appropriately allocated as between the Private Party and the Subcontractors. See Part B: (*Project Documents and Project Deliverables*).

[105] If the PPP Agreement includes suspensive conditions, then the warranties should be given both as at the Signature Date and the Effective Date.

[106] See Part N:55 (*Termination: Termination for Corrupt Acts*).

[107] See Part N: 55 (*Termination: Termination for Corrupt Acts*).

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included in the Project Assets.[108] In User Pay PPPs, a warranty to the effect that the Private Party has conducted its own market analysis and has not relied on any representations in this behalf by the Institution may be desirable.

8.1.3 In order to show its good faith and give the Private Party some measure of comfort, the Institution should consider on a project-by-project basis whether to warrant that it has not knowingly omitted to disclose any material information[109] in its possession or under its control relating to any Institution Assets.

8.1.4 Any other warranties (save as provided in Section 8.1.5) to be given by an Institution must be justified on a project-specific basis. For instance, in the case of "information warranties" in Projects where the Private Party is taking over existing Facilities and Services, warranties regarding such Facilities and Services may be given by the Institution where the Institution is the only source of information and that information cannot be independently verified. All warranties given by an Institution should be drafted with extreme care and limited appropriately.

8.1.5 Where the Institution is not the only source of any information or that information can be independently verified, the Institution must not give any warranties regarding that information. Instead, the Private Party should be required to rely on the results of its due diligence and on any independent surveys made available by the Institution. If no information warranties are to be given by the Institution, then the PPP Agreement should expressly record this and, in addition, provide that the Private

[108] See Part R: 77 (*Intellectual Property: Infringement*).

[109] This warranty (if given) may, for instance, extend to the information obtained by the Institution in the course of its due diligence on the property rights in respect of the Project Site (See Part D:11 (*Project Site: Nature of Land Interests*)) and its site condition surveys (see Part D:12 (*Project Site: Condition of Project Site*)).

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Party shall be solely responsible for identifying all information necessary for the performance of the Project Deliverables.

8.1.6 Warranties from either Party in relation to capacity and authority provide no real benefits since, if any such warranty is untrue, the remedies for breach of warranty in the PPP Agreement will have no significance as the PPP Agreement will not be capable of being enforced. Nevertheless, the Institution should warrant its capacity to enter into the PPP Agreement and the authority of its accounting officer or accounting authority, as the case may be, to execute the PPP Agreement on its behalf in order to provide the Private Party (and its funders) with some measure of comfort.

Standard Clause

Private Party Warranties

The Private Party warrants that:

(a) it has taken all necessary actions to authorise its execution of this PPP Agreement;

(b) all the Project Documents have been duly executed on proper authority and are in full force and effect as at the Signature Date, save for those Project Documents identified in Schedule [x] that will be executed in the Agreed Form after the Signature Date by the corresponding date in Schedule [x];[110]

(c) the execution and performance of any Project Documents do not and will not contravene any provision of the memorandum or articles of association of the Private Party[111]*as at the Signature Date, or any order or other decision of any Responsible Authority or arbitrator that is binding on the Private Party as at the Signature Date;*

(d) all Consents required for the conduct of the Project Deliverables are in full force and effect as at the Signature Date, save for any Consents which are not required under applicable law to be

[110] As a general rule, the Institution should endeavour to ensure that all Project Documents are executed at the same time as the execution of the PPP Agreement. If this is not practical, then the Institution must ensure that the Project Documents in question are in final Agreed Form by the Signature Date and, in any event, that the later execution of them will not delay the running of the Project Term.

[111] Appropriate amendments will need to be made if the Private Party is not a company.

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obtained by the Signature Date; provided that the Private Party warrants that it knows of no reason (having made all reasonable enquiries in this regard) why any such Consent will not be granted on reasonable terms by the time it is required to obtain such Consent;

(e) *no litigation, arbitration, investigation or administrative proceeding is in progress as at the Signature Date or, to the best of the knowledge of the Private Party as at the Signature Date having made all reasonable enquiries, threatened against it, which is likely to have a material adverse effect on the ability of the Private Party to conduct the Project Deliverables;*

(f) *the Private Party is not subject to any obligation, non-compliance with which is likely to have a material adverse effect on its ability to conduct the Project Deliverables;*

(g) *no proceedings or any other steps have been taken or, to the best of the knowledge of the Private Party having made all reasonable enquiries, threatened for the winding-up or liquidation (whether voluntary or involuntary, provisional or final), judicial management (whether provisional or final) or deregistration of the Private Party, or for the appointment of a liquidator, judicial manager or similar officer over it or over any of its assets;*

(h) *all information disclosed by or on behalf of the Private Party to the Institution at any time up to the Signature Date and, in particular, during the bid process preceding the award of this PPP Agreement to the Private Party, is true, complete and accurate in all material respects and the Private Party is not aware of any material facts or circumstances not disclosed to the Institution which would, if disclosed, be likely to have an adverse effect on the Institution's decision (acting reasonably) to award the PPP Agreement to the Private Party;*

(i) *the copies of the executed Project Documents, which have been delivered to the Institution, are true and complete copies of such Project Documents and there are no other documents replacing or relating to any such Project Documents, which would materially affect the performance of these Project Documents; and*

(j) *as at the Signature Date:*

(i) *the Private Party has an authorised and issued share capital as set out in Schedule [x] and all shares in the issued share capital of the Private Party are fully paid up;*

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(ii) all shares in the issued share capital of the Private Party are legally and beneficially owned as represented in Schedule [x];

(iii) save as provided in the Financing Agreements or the Shareholders Agreement, no person has the right (whether actual or contingent) to call for the issue of any share or loan capital in the Private Party whether pursuant to any option or otherwise including on realisation of security; and

(iv) save as provided in the Financing Agreements or the Shareholders Agreement, there is no encumbrance over or affecting any of the Equity or the Shareholder Loans and there is no agreement or commitment to grant or create any such encumbrance;[112]*and*

(k) it has examined the quantum of liquidated damages referred in clauses [x] and has found these to reflect accurately the loss that will result to the Institution upon the [occurrence / non-occurrence] of the events upon which the liquidated damages are payable.

Institution Warranties

The Institution warrants that:

(a) it has taken all necessary actions to authorise the execution of this PPP Agreement; and

(b) it has not knowingly omitted to disclose any material information in its possession or under its control relating to the Institution Assets.

8.2 Institution Warranties and Existing Facilities or Services

8.2.1 The following commentary deals with the specific issue of Institution warranties where existing Facilities or Services are taken over by the Private Party.

8.2.2 If a Project entails the transfer to the Private Party of existing buildings or infrastructure which require substantial refurbishment and repair, the Private Party will be unlikely to assume any risk of latent defects in these

[112] See also the Standard Clause in Part N:55 (*Termination: Termination for Corrupt Acts*), which includes a warranty relating to Corrupt Acts.

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Institution Assets and will probably require warranties from the Institution as to their condition. This is particularly the case in Projects where the existing buildings or infrastructure were constructed and operated according to out-of-date building and environmental standards.

8.2.3 If the PPP Agreement requires the transfer of employees of the Institution to the Private Party, the Private Party will probably require Institution warranties regarding the scope of any pre-Agreement liabilities for pensions and other employment benefits, given that these liabilities are not always capable of accurate calculation and given the legal protections afforded to employees as against new employers.[113]

8.2.4 Since bidders base their bids (including their bid prices) on the information made available by the Institution, the Institution should consider that a blanket refusal to give any of the above warranties might discourage the submission of bids (particularly if the cost of the bidders' due diligence is likely to be exorbitant) and thereby reduce the competitiveness of the tender, or might result in bid prices that are unaffordable and do not provide value for money. The Institution should always consider whether it can obtain better value for money (taking into account the overall risk allocation of the Project) if it is able to give these warranties.

8.2.5 If the Institution is unwilling to give any of the warranties contemplated above because it is unsure about the accuracy of its information, then the Institution must (at its cost) arrange for the appointment of independent consultants who have the appropriate expertise and experience to undertake surveys in order to verify such information.[114] Such surveys

[113] In this regard, see Part L: (*Employment*).

[114] The costs (or reasonable estimates thereof) of the independent surveys should be disclosed in the affordability assessment included in the feasibility study accompanying the Institution's application for the Approval.

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should be commissioned at the feasibility study phase, on the basis that the full results thereof will be disclosed to all the bidders and ultimately be for the benefit of the Private Party who will be entitled to rely thereon. Given that the results of such surveys are made available to all the bidders and as the Private Party will have recourse to the independent consultant, the Institution need not warrant the accuracy of such results. If the bidders require additional surveys to be undertaken (whether by the same or by another independent consultant), then the Institution should commission these surveys on the same basis, but at the cost of all the bidders (to be shared equally among them) unless the Institution will achieve better value for money if it assumes the whole or a portion of these costs. If the Institution's information cannot be independently verified as aforesaid, then the Institution may consider warranting that information, provided this will result in better value for money.

8.2.6 If the Institution is confident about the accuracy of its information, then it may consider warranting the accuracy of such information, unless that information can be easily verified by the bidders themselves without them incurring substantial costs.

8.2.7 The Institution should, however, be careful that its warranties do not extend beyond what is reasonable in the circumstances. In particular, the Institution should not provide warranties in respect of risks that are covered by the Project Insurances which the Private Party has agreed to procure. In this regard, the Institution should bear in mind that the costs of these Project Insurances will be built into the User Charges and therefore passed on to the end users.

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9 INDEMNITIES AND CLAIMS FOR DAMAGES

9.1 Private Party Indemnities

9.1.1 The Institution will want to ensure that the PPP Agreement requires the Private Party to indemnify the Institution against certain losses that may be incurred by the Institution as a result of the Private Party's performance or non-performance of the Project Deliverables. The Private Party will usually make provision for such contingent liability in its bid price to the extent that it is not covered by insurance.[115]

9.1.2 Generally, there are five heads of liability against which the Institution should seek to be indemnified by the Private Party to the extent that such liability arises as a result of the performance or non-performance by the Private Party of the Project Deliverables. These are:

9.1.2.1 property damage;

9.1.2.2 breach of statutory duty;

9.1.2.3 death and personal injury;

9.1.2.4 other third party claims;[116] and

9.1.2.5 breach of a Private Party warranty.

9.1.3 As a general rule, the Private Party's liability under any indemnity should not be capped as this will leave the Institution residually exposed to the extent of such uncapped liability.

[115] The term "indemnity" as used in this Standardisation means an undertaking on the part of the indemnifying party (acting as principal) to compensate or reimburse the indemnified party for certain losses arising in connection with the conduct (whether an act or omission) of the indemnifying party such as a breach of any contractual provision or a breach of any warranty given by it.

[116] See also Part R:77.2Part R:77.2 (*Intellectual Property: Infringement*) for a discussion on specific Private Party indemnities for infringements of third party intellectual property rights.

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9.1.4 Such residual exposure is not acceptable where the Private Party's liability (for example, for property damage) is or ought to be covered by any of the agreed Project Insurances (which are indirectly being paid for by the end users through the User Charges). Thus the Private Party's liability to the Institution for property damage to be covered by the material damage insurances included in the agreed Project Insurances should not be capped because this insurance should cover the full replacement value of the assets. If the Private Party's liability here is capped, it (or its funders) will receive the benefit of the insurance proceeds in excess of the cap. However, an exception may be made in the case of high value Institution Assets if better value for money will be achieved for an Institution by it agreeing to cap the Private Party's indemnity in respect of these Institution Assets.

9.1.5 The Private Party's liability under its indemnity for the breach by it of its statutory duties should also be uncapped, because this liability should be covered by the agreed Project Insurances.

9.1.6 In the case of third party claims (including for death and personal injury), the Institution will generally be opposed to any cap on the Private Party's liability to the Institution under the indemnity because the Private Party will in any event be exposed to the full extent of any such claim should the third party choose to sue the Private Party directly. Here, the Institution will expect the Private Party to rely on its legal liability insurances. However, it may be difficult for the Parties to gauge the appropriate level of insurance cover for third party claims, and the costs of taking out these insurances at levels that the Parties consider appropriate for the Project may be so high as to impact on the required affordability levels for the Project. The Lenders will also be concerned that if the Private Party's indemnity for such claims is not capped, then

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they will be exposed to an unquantifiable residual risk exposure to the extent that the insurance cover is inadequate. On the other hand, the Institution will also have an unquantifiable residual risk exposure to the extent that the Private Party's liability is capped.

9.1.7 Therefore, the Institution should carefully consider, having regard to the nature of the Project, whether there is a substantial likelihood of third party claims and whether these claims can be adequately covered by insurance (particular consideration should be given to the likelihood of third party claims for consequential losses). If there is a high risk of substantial third party claims that may not be adequately covered by the agreed insurances, then a cap should not be agreed unless this has a substantially negative impact on the affordability (through increased User Charges) of, and the value for money required to be provided by, the Project.

9.1.8 In the case of breaches of Private Party warranties, the Institution should consider that insurance is likely to be unavailable or, even if available, very costly. If this is the case, then the Institution should consider whether better value for money might be achieved by it if the Private Party's liability under this head is capped at reasonable levels. The Institution should address the issue of caps in relation to all heads of liability in the RFP and the draft PPP Agreement included therein in order to solicit competition among the bidders. All the bidders must be asked to price for each indemnity on a capped and an uncapped basis and to specify the quantum of any cap they propose. The Institution should bear in mind that setting the Private Party's indemnity exposure at levels where debt service is put at risk may not result in better value for money.

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Standard Clause

Private Party Indemnities

The Private Party indemnifies and shall keep the Institution indemnified at all times against all direct losses[117] *sustained by the Institution in consequence of:*[118]

(a) *any:*

(i) *loss of or damage to property (including, without limitation, any Institution Assets);*

(ii) *breach of a statutory duty arising under applicable law;*

(iii) *claim for or in respect of the death or personal injury of any individual; or*

(iv) *other claim, action, charge, cost, demand or expense,*

(including, without limitation, any legal fees or costs) arising in connection with the performance or non-performance of any Project Deliverables, save to the extent caused by the [gross negligence or][119] *wilful misconduct of the Institution or by a breach by the Institution of an express provision of this PPP Agreement; or*

(b) *any breach by the Private Party of any warranties given by it in this PPP Agreement.*

9.2 Institution Indemnities

9.2.1 The Private Party (and its funders) will typically insist that reciprocal indemnities be given by the Institution in favour of the Private Party. However, reciprocity is not appropriate because:

[117] For projects with a higher risk level for third party death or injury claims, consequential losses for third party death or injury may be considered.

[118] If because of value for money considerations any consequential losses included in any third party claims are to be excluded from the cover provided by these Private Party indemnities, then the reference to "direct losses" should be appropriately qualified. See also footnote 128.

[119] These Private Party indemnities should apply even if the indemnified loss is caused by the negligence of the Institution on the assumption that insurance cover will be available to cover the underlying risks. Depending on the availability and the value for money of such cover, gross negligence on the part of the Institution should also be covered by the indemnity and excluded from the exception.

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9.2.1.1 the Parties do not have identical or even similar roles in the Project. Typically, the Institution's role is limited to facilitating and monitoring the Project, possibly the provision of the Project Site, and in Hybrid PPPs, the payment of the Unitary Payment, whereas the Private Party's role involves the construction of the Facilities and the provision of the Services and is far more extensive; and

9.2.1.2 the Private Party should bear responsibility for the manner in, and the methods by, which it chooses to perform the Project Deliverables.

9.2.2 The non- or late payment of the User Charges is generally not the Institution's risk. To the extent Unitary Payment is involved in Hybrid PPPs, such non or late payment is covered by specific provisions which allow for the accrual of interest at the Default Interest Rate and, accordingly, no Institution indemnity should be given in this regard (see the specific drafting in this behalf in the Unitary Payment Standardisation under Termination for Institution Default). As for the non-availability of the Project Site, the Institution should determine at the feasibility study phase whether this should be a Compensation Event or covered by an Institution indemnity. The choice of compensation mechanism here should be determined on a project-by-project basis.

Commented [eik1]: No indemnity for UCs non-payment.

9.2.2.1 While the non- or late payment of the User Charges is generally not the Institution's risk, the Institution may be required to use its legal powers to recover User Charges from defaulting end users. Such arrangement will be required where the legal regime does not enable delegation of the 'police' powers of the Institution to the Private Party, and where, given the nature of the Services, billing and payment of the User Charges is in arrears. To illustrate, while the Private Party may refuse entry to a road

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user on a toll road who does not pay the toll charge on entry, in a water supply scheme the billing will usually take place in arrears (say at the end of the month). While the Private Party may enjoy the 'contractual' – as opposed to statutory – powers to disconnect a defaulting end user, a higher number of defaults will increase the bad-debts of the Private Party and erode its cash flows and, thereby, the capacity for debt service and the return for the shareholders. The Private Party may not be able to reduce its fixed costs in the short run and will run the risk of a higher per end user fixed cost than originally forecast. To cover for such contingencies, the bidders will likely build a cushion in their bids that will reduce the value for money for the Institution and the end users.

9.2.2.2 Accordingly, the value for money will likely increase if the Institution offers the use of its statutory enforcement powers to recover User Charges where it is permissible under the laws governing the underlying Institutional function. The Institution must obtain legal advice before making any representations or commitments in this behalf in the RFP. The costs for any such recovery measures should be for the account of the Private Party, on the basis that such costs would have been incurred by the Private Party if it enjoyed the recovery powers.

9.2.2.3 The Institution must therefore not give any indemnity in relation to payment obligations of the end users, or in relation to any commitments to use its legal powers for forced recovery of past due User Charges, without obtaining legal advice.

9.2.3 At the time when the RFP and proposed PPP Agreement are being prepared, the Institution should carefully consider, having regard to the nature of the Project, whether there are any other circumstances peculiar to the proposed Project which would justify the giving of indemnities by the Institution. Whatever these circumstances may be, no indemnities

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should generally be given by an Institution where the underlying risks in respect of which indemnification is sought may be mitigated by any of the Project Insurances,[120] or where the PPP Agreement specifically provides for other compensation to be paid to the Private Party (for example, under the Compensation Event mechanism). In the case of conduct that would not be covered by these insurances or some other compensation mechanism provided for in the PPP Agreement, indemnities should be given (whether on a capped or uncapped basis) if and to the extent this will achieve better value for money. These indemnities must be carefully drafted.[121]

9.2.4 The Institution must also obtain legal advice regarding its capacity and authority to grant any indemnities in light of the statutes governing the Institution.

9.3 Direct Losses

9.3.1 Care should be taken to ensure that the losses covered by any indemnities are always limited to the direct losses of the indemnified party. All indirect or consequential losses of the indemnified party, such as loss of profits, loss of use, loss of production, loss of business or loss of business opportunity, should be expressly excluded from all indemnities.

9.3.2 Of course, the indemnified party's direct losses in respect of third party claims might include third party claims for indirect losses (such as the third party's lost earnings or profits). This is partly why the Parties may have difficulty gauging the appropriate levels of insurance cover for third party claims and why the Lenders may insist on a cap for Private Party

[120] The only exception here is in relation to the risk of latent pre-transfer environmental contamination at the Project Site for which indemnities may be given (depending on value for money considerations) even where this risk is covered by any of the Project Insurances.

[121] The indemnities should clearly exclude any liability on the part of the Institution to the extent caused (whether directly or indirectly) by the Private Party.

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indemnities in respect of third party claims. Institutions should therefore consider on a project-by-project basis whether or not to exclude third party indirect losses from any indemnity for third party claims.

9.4 Third Party Claims Procedure

With regard to any indemnified third party claim, the PPP Agreement should set out provisions governing the conduct of such claims, pursuant to which:

9.4.1 the indemnifier will be obliged to notify the indemnified of any such claim within a specified period of the indemnifier obtaining any actual knowledge of it;

9.4.2 subject to the terms of the policy in respect of any Project Insurance, the indemnifier will be entitled to dispute any such third party claim in the name of the indemnified (but at the cost and expense of the indemnifier);[122]

9.4.3 the indemnified will give the indemnifier all reasonable co-operation and assistance in relation to such dispute;

9.4.4 in relation to any third party claim disputed by the indemnifier in the indemnified's name, the indemnifier will be obliged not to bring the name of the indemnified into disrepute, and to keep the indemnified fully informed of the conduct of such claim, and will be prohibited from paying or settling such claims without the prior consent of the indemnified;

[122] The Institution should be cognisant of the reputational risks of litigation being conducted in its name by a third party, such as the Private Party. The provisions of the third party claims procedure in the PPP Agreement must therefore permit the Institution to take over any litigation. However, typical insurance policies do not permit this as insurers usually seek the right to control any litigation. Specific advice on this issue should be obtained from the insurance broker placing the Project Insurances.

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9.4.5 if the indemnifier does not exercise its right to dispute the claim in the name of the indemnified, then the indemnified should be entitled to pay or settle such claim;

9.4.6 the indemnified should be entitled to take over the conduct of any claim against its release of the indemnifier from liability under the indemnity in respect of such claim; and

9.4.7 if the indemnified has received an indemnifying amount from the indemnifier and subsequently recovers a sum from the third party, the indemnified should repay the indemnifier to the extent that the sum recovered (plus the indemnifying amount) exceeds the loss sustained by the indemnified.

9.5 Claims for Damages

9.5.1 Unlike Unitary Payment PPPs, the Institution's reliance on general damages claims may be difficult in User Pay PPPs, as it would be quite difficult to quantify the general damages suffered by the end users due to delay in construction of the facilities or a design default. The Private Parties will typically argue that (save where performance or non-performance of the Services may give rise to any type of liability contemplated in Section 9.1.2 (that is, death or personal injury, loss of or damage to property, and so forth)) the Institution should not seek to rely on its general damages claim or indemnities to provide remedies for poor or non-performance of the Services during the Project Term, because the User Charges PPPs are generally structured on "no Service, no User Charges" basis, such that non-availability of Services will translate into User Charges not being billed by the Private Party. Further, the Penalty Deductions will create adequate incentive for the Private Party to keep the Service available up to the contractually agreed standards.

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9.5.2 However, the Institution should bear in mind that reliance on Penalty Deductions may not be truly compensatory for the losses incurred by the end users in *all* circumstances. The Institution must therefore be cognisant of any circumstances where its reliance on the Penalty Deductions may be misplaced because the Penalty Deductions will not be available at all (or will be insufficient) to be truly compensatory. This will be the case in relation to Private Party breaches that occur in the construction or development phase of the Project, that is, before Service Commencement, because Penalty Deductions are to accrue only after Service Commencement for the unavailable or poorly performed Services. The end users may continue to suffer 'losses' , for instance, where because of a delay in the construction of a toll road the end users are compelled to use alternative congested roads, that costs them higher in terms of fuel, travel time and lost business hours. . However, it is not possible to quantify such damages. Further, as the law treats damages as 'compensatory', it would be extremely difficult, if not impossible, to correlate the quantum of damages to the actual losses suffered by a multitude of end users.

9.5.3 A general damages claim may, therefore, not provide better value for money because the quantum of damages likely to be obtained pursuant thereto will not be predictable or quantifiable. This may also impact negatively on bid prices and possibly even discourage the submission of bids. So the Institution should aim for the compensatory mechanism for such losses to be built in the Performance Security[123], in the form ofliquidated damages, an indemnity or a combination of these.

9.5.4 The exclusion of a general damages claim should also apply to the Private Party, as its losses arising in connection with the Institution's

[123] See Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*)) .

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conduct should be covered by other compensation mechanisms in the PPP Agreement such as Compensation Events or Institution Variations. The Private Party's losses arising from breaches by the Institution of its obligations under the PPP Agreement will generally be catered for in the Compensation Event mechanism (unless such breach is covered by any specific Institution indemnities, which may be the case in relation to a breach of the Institution's obligation to provide vacant and undisturbed possession of the Project Site).

9.6 Post-termination

On termination for Private Party Default, the termination compensation (even if based on the market value calculation) may not reflect all the Institution's losses (including its indemnified losses). To the extent that these losses are not included in such termination compensation, the Institution's right to claim these losses should continue to be exercisable after termination.

Standard Clause

Limitations on Liability

(a) Save for the Institution's right to claim at any time the amount of any direct losses incurred by it as a result of rectifying or mitigating the effects of any Private Party Default and any other express right of the Institution under this PPP Agreement (including any express right to indemnification), [the sole remedy] [124] *of the Institution in respect of any failure in the delivery of the Services*[125] *shall be the operation of the Penalty Deductions in accordance with the provisions of Schedule [x].*

(b) Nothing in Clause (a) shall prevent or restrict the right of the Institution to seek any injunction or similar relief, any decree of specific performance or any other discretionary remedies of a court.

(c) [If the Private Party is expressly entitled to any indemnification under this PPP Agreement for any losses incurred by it whether because of the conduct of the Institution or any other cause, then the Private Party's

[124] The Institution must carefully assess this limitation in light of a thorough analysis of any financial losses that may not be covered by the payment mechanism.

[125] Clause (a) does not extend to the Project Deliverables relating to the construction phase of the PPP Agreement.

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sole remedy in respect of such losses shall be its indemnity and, accordingly, it shall not be entitled to any other remedy for such losses whether pursuant to Clause [x][126] or otherwise.][127]

(d) No Party entitled to any indemnification or other compensation under this PPP Agreement for any losses incurred by it, whether because of the conduct of the other Party or for any other cause, shall be entitled to:

(i) any claim for damages for breach of contract, in tort or on any other basis in respect of such conduct or cause; or

(ii) any claim for indirect or consequential losses (including any loss of profit, loss of use, loss of production, loss of business, loss of business opportunity) incurred by it as a result of such conduct or cause.[128]

(e) The Institution shall not be liable whether in contract, in tort or otherwise, to the Private Party in respect of any negligent act or omission of the Institution, its employees, officials, representatives or guests, which is or ought to be insured against pursuant to the Project Insurances. The Private Party has agreed to this on the basis that it shall mitigate the risks of any such negligent acts or omissions on the part of the Institution by obtaining and maintaining the Project Insurances.[129]

10 DOUBLE RECOVERY AND MITIGATION

10.1 The PPP Agreement must provide that neither Party should be entitled to recover (whether pursuant to an indemnity or otherwise) any loss to the extent that it has already been compensated for that loss whether by way of insurance or otherwise.

10.2 Each Party should also be under an obligation to mitigate the consequences of any conduct in respect of which it is entitled to compensation under the PPP Agreement (whether by way of an indemnity or otherwise).

[126] The Clause referred to here is the Clause dealing with Compensation Events.

[127] This Standard Clause should be deleted if no Institution indemnities are given.

[128] Having regard to Section 9.3.1, this Standard Clause may need to be amended to exclude third party consequential losses included in the direct losses of the indemnified party.

[129] See Part I: (*Insurance*).

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PART D: PROJECT SITE

11 NATURE OF LAND INTERESTS

11.1 Introduction

11.1.1 Land for PPP may be (A) owned by the Institution, (B) owned by another public organisation and made available to the Institution, or (C) procured by the Private Party itself. In other cases, land may be procured using the machinery provided in the Land Acquisition Act, 1894. Combinations of the foregoing land procurement options are also possible. In some PPPs that involve the construction of infrastructure, the Institution will make land (sometimes with existing buildings and infrastructure located thereon) available to the Private Party. During the Project Term the Private Party will manage the operation and maintenance of such land and infrastructure.

11.1.2 Consideration should always be given to the nature of the interest that the Private Party should have in the land and infrastructure during the Project Term.

11.1.3 Title and interests in the land are one of the fundamental matters to be looked at for each PPP Project as the absence of a central easily accessible land title database makes ascertainment of title in some cases a significant task. Land may be urban or agricultural, with the record of the former being available with the relevant municipal body owning the land and for the latter examination of the Register of Rights is called for. Title to the land already vesting in the Institution will be the easiest to establish to the bidders. In other cases,the Institution must commission a thorough investigation by appropriately qualified experts of all property rights in, and all title and land use restrictions attaching to, the land (and any improvements thereon) at the feasibility study phase of the Project to

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ensure that the Project will not be jeopardised due to a late discovery of a third party claim to the land or a land-use restriction that could delay or prevent the construction of the Facilities on the land or interfere with the Private Party's possession of the land.

11.1.4 If this investigation exposes any such claims or restrictions which cannot be resolved or lifted in the feasibility study phase of the Project, then the Institution should opt for another Project Site (repeating the investigation exercise) or, if it does not wish to do so, then it should postpone the procurement phase of the Project until these claims or restrictions are resolved or lifted.

11.1.5 If the Private Party and its funders are concerned about third party interference in the Private Party's possession of the Project Site during the Project Term for land provided by the Institution, they will expect the Institution to agree to the Private Party being compensated for its losses arising from such interference. The Institution may agree to appropriate compensatory relief (whether in the nature of an Institution indemnity or a Compensation Event) in this regard if this will ensure better value for money. However, such protection should be offered only for known and specific adverse claims to the title that have been discovered (and which do not prevent effective transfer of land rights by the Institution in favour of the Private Party subject to such adverse claims).

11.1.6 Land that is not vested in any Institution, including municipal entities[130], will generally be owned by the Provincial Governments. Such land can be made available under the Colonisation of the Government Lands Act, 1912 (with respective amendments made by each Province). In other

[130] After the promulgation of the Local Government Ordinances, 2001 by all Provincial Governments, substantial parcels of land have become vested in the respective local government institutions (see Section 121). However, being a recent legislation, its precise impact in terms of the title to land vested in the local government institutions is not ascertained. Hence through investigation of title and other interests in the land owned by the local government institutions must be carried out before offering the land as available under the bidding documents.

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cases, privately owned land may be acquired by the Provincial Government and given to the Private Party under the provisions of the Land Acquisition Act, 1894, a discussion over which follows later.

11.1.7 In Projects where the Private Party purchases or leases land itself with its own resources, the Institution should not provide any indemnities or accept any Compensation Event in relation to any defects in title or for encumbrances on the land, or in respect of any related rights such as access rights. These matters should remain for due diligence by the Private Party and the Institution should not assume any risk in such cases. As title (and access rights) verification is a risk that can be managed by the Private Party by the exercise of due diligence, defects in title or subsequently discovered encumbrances should not constitute a Relief Event either, and Penalty Deductions should continue to apply in that case.

11.2 Land Transfer or Purchase

11.2.1 As part of the Institution's feasibility study for a proposed Project, the Institution should consider:

11.2.1.1 the extent to which it will be required to make land and improvements available to the Private Party so as to allow the Private Party to carry out the Project Deliverables;

11.2.1.2 its ability to make such land and improvements available to the Private Party. Here special consideration should be given to any defects in title including those arising from any land claims made before the Institution, the Land Revenue Departments or in litigation;

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11.2.1.3 the nature of the legal interest in the land and improvements which the Private Party will acquire pursuant to the PPP Agreement or any ancillary documents;

11.2.1.4 whether any consideration will be payable by the Private Party for such interests or whether such consideration will be provided for through reduced User Charges[131]; and

11.2.1.5 the extent to which the Institution will require access to or some measure of control over the land and improvements during the Project Term.

11.2.2 If the Project will involve the Institution accessing and using the site (for example, in a hospital project where hospital clinical staff employed by the Institution will require access to the hospital managed and maintained by the Private Party), then the Institution should seek legal advice prior to commencing the procurement process to ensure that the Institution's rights of access and use are properly protected after the Institution Asset is made available to the Private Party.

11.2.3 In a particular Project the Institution may already own (in the sense of having registered title) the land and improvements. In this case, it can transfer an interest in the land and improvements to the Private Party (for instance by way of a lease), while at the same time securing for itself an interest in the land (by way of a sub-lease) which allows it access to and use of the land and improvements for the Project Term of the PPP Agreement.

11.2.4 If the Institution has a lease interest in the land, then it is likely that the

[131] This ought generally be the case for land owned by the Institution itself. For land acquired under the Land Acquisition Act or the Colonisation of Government Lands Act, the Private Party will be required to pay consideration to the Government in the former case and to the affectees in the latter.

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consent of the lessor of the land (which could be an individual or a non-governmental entity or, more likely, another organ of state) will be required before the Institution is able to grant any interest in the land to the Private Party. If the nature of the land interest to be granted to the Private Party or to the Institution, as the case may be, is that of lease, and that lease is of a long-term nature (1 year or more), such lease would require to be registered under the Registration Act 1908, along with payment of stamp duties and registration fee.

11.2.5 In some PPPs, it may be necessary for a site over which the Institution has no interest to be obtained. Where the location of a Project Site is critical to the success of the Project and the Institution wishes to acquire legal title in and to any Facilities to be constructed thereon by the Private Party, then the Institution should obtain appropriate interests in the site at the time of the feasibility study phase of the Project.

11.2.6 Where the location of the Project Site is not critical to the success of the Project, the bidders may be encouraged to offer solutions in respect of the land needs of the Project. The Institution should bear in mind, however, that it could be faced with the untenable choice of the "best site" versus the "best bid". Furthermore, the bidders' costs of reserving their respective sites may be so great that some may be discouraged from bidding. Accordingly, unless the Institution is confident that such a conflict will not arise and that the bidding competition will not be negatively impacted by a request for site solutions from the bidders, the Institution should avoid this route.

11.2.7 Where land and property owned by the Institution become surplus as a result of the Project and the Institution wishes to sell the land as an incentive for participation in the tender and thereby obtain a better contract price, the Institution must ensure that it complies with the statute

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governing the Institution dealing with the disposal and letting of immovable property of the Institution and any other applicable law.[132] The Institution needs to ensure that the inter-relationship between the realisation of proceeds from the sale of surplus land, and the Facilities from which the Services will be delivered during the Project Term, support the overall objectives of the Project and do not prejudice the Institution's position should an event of early termination arise.

11.3 Land Acquisition Act

11.3.1 Land required for 'public purposes' may be acquired using the machiney provided in the Land Acquisition Act, 1894 ("LAA"). Being a Provincial legislation, each Province is empowered to make amendments to the LAA in so far as it applies in that Province. The land acquired under the LAA may be vested by the Provincial Government in the Institution or to a 'company'; in the latter case it will be the Private Party. There is detailed case law on what constitutes 'public purpose' and expert legal advice ought to be obtained by the Institution before moving a request to the Provincial Government for acquisition of land under the LAA to prevent later judicial challenges to the objective of acquisition. Generally, where the PPP is for delivery of public services that fall within the statutory functions of the Institution, it may be expected that the public purpose test will be met. The public purpose test will rarely be met where the land is required by the Private Party for its commercial objectives[133].

11.3.2 The Provincial Government is empowered under the LAA to lay down conditions for use of land when made available to a company, as well as the price for such land payable to the Provincial Government. In

[132] These may include the land disposal regulations of the Land Revenue Department.

[133] For example, for constructing and operating a mall or an amenity centre.

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particular, the LAA provides that such acquired land may not be transferred, mortgaged or leased without the previous sanction of the Provincial Government[134]. In such cases, adequate coordination should precede the acquisition process, in order that the terms of vesting do not contain any conditions that may contradict or substantially increase the cost of performance of the Project Deliverables. In particular, the terms of vesting ought to contain prior 'standing' consent of the Provincial Government to creation of mortgage or other security interests in the land in favour of lenders to the Project as well as for exercise of lender-step in and Institution step-in rights.[135]

11.3.3 Compensation at the market rate is payable to the owners of the land from whom land is acquired under the LAA. For smaller projects, the compensation may be in small sum and it would simplify the bidding process if the Institution were to pay the compensation itself and later claim it from the Private Party either through a direct repayment or by reduction in the User Charges. In larger projects[136], the total amount of compensation may become a significant sum that may be beyond the financial means of the Institution to pay. The options could either be for the acquisition process to be completed subject to payment of compensation that can later be paid by the Private Party or to make the acquisition of land a 'suspensive condition'[137]. In either case, the creation of a 'compensation fund' will be critical to prevent litigation ensuing for delayed or non-payment of compensation[138]. In such cases,

[134] There is a broad exemption from the machinery of the LAA where there is in existence an agreement between a company and the Federal or the Provincial Government whereby the said Governments are bound to provide land to the company (Section 42 of LAA). This provision is only applicable where the PPP Agreement is directly made with the said Governments and will not apply where the contracting party is a statutory institution or sub-division of the said Governments with its own independent legal existence. Specific legal advice may be sought on a case-by-case basis.

[135] See Part O: (*Step-in*)

[136] For example, a toll-road project.

[137] See discussion under Section 3 of this Standardisation.

[138] The compensation fund should ideally be placed under the control of the Institution itself, and not with the Provincial Government, as the Project scheduling and progress will be under the control and administration of the Institution.

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the terms of acquisition must stipulate annulment of the acquisition process if the compensation fund is not funded by the Private Party by a stipulated date, that should generally be no later than the start of the construction Works. On the other hand, if the compensation fund is funded by the stipulated date, delay in acquisition will not be a risk that the Private Party will be prepared to assume. In such case the appropriate solution could be for such delay to constitute a Relief Event[139].

11.3.4 Settlement of displaced persons must receive special attention in the process of acquisition under the LAA. Though not a direct responsibility of the Institution itself, projects funded wholly or partially by the multilateral donor agencies will require adherence to their respective resettlement policies and the Private Party may not be able to receive funding if resettlement has not been made according to those policies. The Institution ought to work in close coordination with the Provincial Government while devising the acquisition process so that these resettlement policies are taken into account well in advance.

11.4 Legal Nature of Land Interests

11.4.1 The legal nature of any land interests that may be granted to a Private Party under a PPP Agreement depends on:

11.4.1.1 the nature of the use rights which the Private Party needs to acquire in order to perform the Project Deliverables; and

11.4.1.2 whether or not the Private Party will be required to pay any consideration for such use rights and, if so, the amount of that consideration.

[139] See Part J: Relief Events

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11.4.2 The terminology used to describe a land-use arrangement (that is, "lease", "concession", "land availability agreement", and so forth) is not decisive as regards the legal nature and treatment of that arrangement.

11.4.3 The essential features of a lease are that:

11.4.3.1 the lessee is granted the rights of use and enjoyment of the leased property, with the corresponding obligation to restore that property to its original form as at the commencement of the lease. If the rights conferred under a contract are wider than such use and enjoyment, that is, they entitle the "lessee" to destroy, appropriate or otherwise dispose of the "leased" property thereby diminishing its original substance, then the contract is not a lease;[140] and

11.4.3.2 the lessee must pay monetary consideration (fixed or otherwise clearly ascertainable) for its rights of use and enjoyment. The absence of this obligation indicates a contract of "loan", not a lease.[141]

11.4.4 Several important legal consequences flow from leases (as opposed to, for instance, concessions or loans), such as:

11.4.4.1 simply stated, the rights of use and enjoyment held by a lessee in occupation of the leased premises are "real" (that is, they are enforceable against third parties, including creditors, of the lessor and subsequent title holders, which means that they survive subsequent changes in ownership of the land) as opposed to

[140] For example, a contract pursuant to which the "lessee" has the right to fell and remove non-self-renewing indigenous trees located in an area is not a lease since these rights diminish the substance of the "leased" area.

By contrast, a contract pursuant to which a lessee has the right to fell and remove a crop of self-renewing trees is a lease because the substance of the leased area is not diminished.

[141] The only exception to this requirement for consideration sounding in money is an agricultural lease, where the consideration may be in the form of an ascertainable portion of the crop produced.

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"personal" (that is, binding only as against the lessor and not against third parties);

11.4.4.2 long leases (that is, leases with a duration of 1 year or more) must also be registered to ensure that these rights remain "real" over the full duration of the lease, failing which these rights (after 1 year and even if the lessee remains in occupation) will not generally be enforceable against third parties;

11.4.4.3 if the long lease is in respect of a portion of land, that portion will have to be subdivided. This entails a separation of the portion by way of a diagram and meeting all conditions for subdivision imposed by the responsible local authority under applicable municipal by-laws;

11.4.4.4 a registered long lease can be specially mortgaged or hypothecated since it is regarded in law as a form of immovable property;

11.4.4.5 the common law security interests of a lessor (that is, a tacit hypothec) in the movables located on the leased premises which become operational when rent is overdue; and

11.4.4.6 the requirement for stamp duties, and where registration is required, the registration fee,to be paid on leases.

11.4.5 The above legal consequences do not attach to other forms of land-use arrangements such as a concession. There is no generally accepted legal definition of "concession". They are, however, distinguishable from leases in so far as the nature of the rights conferred by them are "personal". Concessions may or may not involve the grant of use rights in respect of land but to the extent that they do, such rights are ancillary

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to other rights included in the concession[142]. A typical example of a concession is where the concessionaire is granted an exclusive right to carry on a trade (for its own commercial purposes) or operate a service (on behalf of the concessor) in an area, together with an ancillary right to use a piece of land in that area in connection with that trade or operations.

11.4.6 In other case the Government may 'grant' land for the Project. Such grant may be made under various legislations, including the Colonisation of the Government Lands Act, 1912 or the Grant of Government Lands Act, 1880. In such cases, attention must be paid to the general or special terms of the grant. The terms of the grant ought to stipulate assignment of the grant in favour of the Institution upon termination or expiry of the PPP Agreement or upon exercise of 'Institution Step-in" or in favour of lenders who may in turn assign the grant to a successor Private Party in case of exercise of 'Lender Step-in'[143].

11.4.7 A PPP may of course involve a combination of land-use arrangements including a concession, a lease, grant or land acquired under the LAA. This will depend on the particular circumstances of the PPP in question. The agreement between the Parties regarding the land-use arrangements is typically separate from the PPP Agreement itself and is referred to in this Standardisation as the "Project Site Agreement".

11.4.8 In all cases, the Institution should require the bidders to satisfy themselves of the title related to and other interests in the Project Site. Except where the Project Site is already owned by the Institution itself[144] (and that too after the Institution having satisfied itself through its legal

[142] Thus all land use rights will automatically come to an end when a concession expires or terminates. On the other hand, land use rights under a registered lease will continue to be available regardless of termination of the PPP Agreement, unless the lease specifically provides for its termination upon termination of the PPP Agreement.

[143] See Part O: (*Step*-in)

[144] In that case it will be justified. See discussion under Section 8.1.5.

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advisers), the Institution should provide no warranties or indemnities as to title in the Project Site.

Standard Clause

Project Site Agreement

(a) *Project Site*

(i) *The Private Party shall undertake the Works and deliver the Project Deliverables on [out of[145]] the Project Site [made available to][acquired or owned by] the Private Party in terms of the Project Site Agreement.[146]*

(ii) *The Private Party shall throughout the progress of the Works and the conduct of the other Project Deliverables have regard for the safety of all persons at the Project Site (whether lawfully or not) to the extent required by law, and shall keep the Project Site, the Works and the Facilities in an orderly state as appropriate in accordance with Good Industry Practice to avoid danger to such persons.*

(iii) *With effect from the Expiry Date, the Private Party's unencumbered interest in the Project Site Agreement shall [automatically be assigned to the Institution, without the need for any further formality to give effect to such assignment][147]. The Private Party shall not be entitled to any compensation in respect of such assignment. Notwithstanding the aforesaid, the Private Party shall, on demand of the Institution, duly execute all documents including any variation to the terms of the Project Site Agreement, which may be required by the Institution in connection with such assignment.*

(b) *Compliance with Title Deeds*

The Private Party shall procure that:

[145] E.g. an IPP may be required to deliver power at a grid station that is beyond the Project Site.

[146] In cases where the Project Site is acquired by the Private Party out of its own resources, appropriate modifications to this clause will have to be made. The Project Site Agreement will nonetheless be required to provide for Institution Step-in or transfer of the Project Site to the Institution on termination or expiry of the PPP Agreement.

[147] This formulation will work where the Project Site is made available under the LAA or a Government grant. In case of a lease by the Institution, the freehold will revert to the Institution on termination or expiry of the leasehold. In cases where the Project Site is acquired by the Private Party, appropriate documentation and transfer formalities such as execution and registration of a Deed of Conveyance will be required. Particular attention must be paid in the Project Site Agreement to the required formalities for transfer and the responsibility for payment of the then prevailing stamp duties, registration fees and other taxes on transfer.

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(i) all Project Deliverables carried out at the Project Site by or on behalf of the Private Party whether before, during or after the completion of the Works shall be carried out in a manner that does not breach any conditions of the title deeds of the Project Site; and

(ii) there shall be no conduct which gives rise to a right on the part of any person to obtain title to the Project Site or any part of it save in accordance with the terms of this PPP Agreement and the Project Site Agreement.

11.4.7 The Project Site Agreement should deal with the Private Party's access rights on a non-exclusive basis where the Institution requires access and use rights in respect of the Project Site to provide any core services or otherwise discharge its statutory functions (as in the case of a hospital or other accommodation project). To ensure that the Institution's ability to provide its core services and discharge its functions are preserved, these access rights must be retained even in the event of a breach by the Institution of its obligations. Here the Private Party should rely on its remedies pursuant to the Compensation Event mechanism.

11.4.8 Even in those PPPs where the Institution does not require access to or use of the Project Site and the Private Party is entitled to exclusive possession of the Project Site, the Institution should be cognisant of the possibility that it may still need to regain access to or even full possession of the Project Site, for example, during an Institution step-in or on early termination of the PPP Agreement.

11.5 Tax Considerations

11.5.1 The nature of the land interest to be granted to a Private Party may impact on any tax benefits that the Private Party may seek in connection with the expenditure incurred by it in relation to improvements to the land.

11.5.2 It is essential that the taxation consequences of the choice of land interest be thoroughly considered and that specialist tax advice in this regard be

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obtained. This is because any negative taxation consequences (for example, the Private Party's inability to claim allowances) flowing from an Institution's preferred land-use arrangement will influence the bid price and ultimately the value for money afforded by a project.

11.5.3 Notwithstanding that the Institution may for various reasons have a preferred position regarding the appropriate land arrangements for a particular project, the Institution should request comment from the bidders early on in the procurement phase regarding the taxation consequences of the Institution's preferred position.

11.5.4 Except where the Institution itself is the primary occupant of the Project Site[148], the responsibility to pay all taxes, cesses and charges related to the occupancy and use of the Project Site[149] should be for the account of the Private Party and should be factored into the financial model.

12 CONDITION OF PROJECT SITE

12.1 Investigations

12.1.1 The Institution must require the bidders to conduct a thorough investigation of the proposed Project Site, including any existing buildings or infrastructure located thereon and site conditions. The site condition investigation should include surveys of the climatic, hydrological, hydrogeological, ecological, environmental, geotechnical, archaeological and palaeontological conditions at the Project Site. The scope and extent of such investigation will depend on the complexity of each bidder's design and engineering proposal for the Works to be erected at the Project Site.

[148] For instance, in an office building construction and/or refurbishment and maintenance project.

[149] These should include property taxes if this achieves better value for money.

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12.1.2 If the Project Site has existing buildings or infrastructure that will be taken over by the Private Party for the performance of the Project Deliverables, then the Institution should be cognisant of any practical limitations that may affect the Private Party's ability to properly investigate the Project Site.

12.1.3 In Projects involving:

12.1.3.1 the take-over and the upgrading, refurbishment and/or repair of an existing building and/or infrastructure that is large and complex; or

12.1.3.2 the construction of a new building and/or infrastructure that is large and complex (for example, if the construction will span several locations not adjacent to one another or a large geographic area, like a rail project),

to be used in the provision of the Services, the costs of these investigations are likely to be so high that the private sector may be discouraged from bidding unless those costs are shared.

12.1.4 In such Projects, the Institution may achieve better value for money if it commissions (at its own cost) some of the surveys that should form part of the bidders' investigations, particularly the structural stability survey (in the case of existing buildings and infrastructure) and the geotechnical survey from appropriately qualified and experienced independent experts, each on the basis that the results of such surveys may be made available to all the bidders and for the benefit of the Private Party. The Institution must ensure that the Private Party will have recourse to the independent experts if such surveys are inaccurate. Such surveys should generally be commissioned and undertaken at the feasibility phase of the Project, and

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the costs thereof (or a reasonable estimate of such costs) must be included in the affordability analysis required under the Regulatory Instruments .[150]

12.1.5 The key purpose of these feasibility phase surveys is to uncover at the earliest opportunity any site condition problems that may cause regulatory delays in the implementation of the Project or that could have such a significant impact on the cost structure of the Project that its affordability and value for money may be negatively affected. These surveys should therefore assist the Institution in determining whether or not its choice of Project Site will help it achieve better value for money.

12.1.6 Should any material site condition problems be discovered at the proposed Project Site and, in spite of this, the Institution still wishes to proceed with the location of the Project at such Project Site, then the Institution must inform the Approving Authority of these problems. The Approving Authority is likely to require the Institution to implement mitigation measures satisfactory to the Approving Authority (including obtaining any necessary Consents from any Responsible Authorities having jurisdiction, or concluding inter-governmental agreements with affected Responsible Authorities to fast-track the resolution of any required Consent applications), before proceeding with the procurement phase of the Project.

12.1.7 Although the results of such surveys should be made available to all the bidders, and the Private Party should be entitled to rely on these results with full recourse to the independent expert[151] if such surveys are inaccurate, nevertheless as between the Institution and the Private Party,

[150] If so requested by the bidders, during the bid phase further surveys may be undertaken on the same basis by independent experts. The costs of these further surveys must be shared equally among all the bidders, unless the Institution can achieve better value for money by assuming the whole or part of these costs.

[151] The independent expert/surveyor must be a credible entity or else the bidders will not attach value to the findings of such survey and may build the costs of additional surveys in their bids.

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the Private Party will remain responsible for undertaking all investigations of the Project Site. The Institution should bear in mind that since the Private Party bears all design and construction risks associated with any Works included in the Project Deliverables, the Private Party should also undertake all such investigations as are necessary for it to develop a design and construction proposal that is best suited to the conditions at the Project Site. The Institution should never assume any risk of the Private Party's design and construction proposals being unfit or unsuited for the Project Site.

12.1.8 The Private Party (and its funders) will typically request the Institution to warrant the accuracy of all site condition survey reports made available by the Institution to the Private Party. Such warranties should not be given if the surveys were undertaken by independent experts and on the basis that the results thereof could be relied upon directly by the Private Party for its own benefit.[152]

Standard Clause[153]

Project Site Conditions

(a) *The physical and the ambient conditions including climatic, hydrological, hydrogeological, ecological, environmental, geotechnical, geological, palaeontological and archaeological conditions of the Project Site (the "**Project Site Conditions**") shall be the sole responsibility of the Private Party. Accordingly, without limiting any other obligations of the Private Party that are included in the Project Deliverables, the Private Party shall be deemed as at the Signature Date to have:*

[152] See also Part C: 8.1.4 to 8.1.6 (*General Obligations: Warranties*).

[153] This Standard Clause assumes that the Private Party has been given the opportunity to undertake a thorough investigation of the Project Site and further that the Institution has not assumed any risk in respect of pre-transfer environmental conditions at the Project Site.

This Standard Clause will have to be amended, as appropriate, if and to the extent that the Private Party was not able to undertake a thorough investigation of the Project Site (for example, because of practical limitations related to existing buildings or infrastructure on the Project Site) or the Institution has assumed any risk in respect of pre-transfer environmental conditions at the Project Site.

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(i) carried out an investigation of all Project Site Conditions and of any extraneous material in or under the Project Site including its surface, sub-soil and ground water to enable the Facilities to be designed and constructed and the Works to be carried out with due regard for the Project Site Conditions and the seismic activity (if any) in the region of the Project Site;

(ii) for the purpose of such investigation in section (i), inspected and examined the Project Site and surroundings;

(iii) satisfied itself as to the nature of the Project Site Conditions, the surface, sub-soil and ground water of the Project Site, the form and nature of the Project Site, the load-bearing and other relevant properties of the Project Site, the risk of damage to property affecting the Project Site, the nature of the materials (whether natural or otherwise) to be excavated and the nature of the design, works and material necessary for the execution of the Works;

(iv) satisfied itself as to the adequacy of its right of passage over, access to and through the Project Site and any accommodation it may require for the purposes of fulfilling any of its obligations included in the Project Deliverables, such as any additional land or buildings located outside the Project Site;

(v) satisfied itself as to the possibility of interference by persons with rights-of-way across, access to or use of the Project Site with particular regard to the owners and users of any land adjacent to the Project Site; and

(vi) satisfied itself as to the precautions, times and methods of working necessary to prevent or minimise nuisance or interference being caused to any third parties.

(b) To avoid doubt, the Private Party accepts full responsibility for all matters in Clause (a) and the Private Party shall:

(i) subject to Clause [x][154], not be entitled to make any claim against the Institution whether in contract, tort or otherwise[155] on any ground relating to the matters in Clause (a); and

[154] This must refer to the Clause setting out the Institution's warranty relating to the wilful non-disclosure of information. See the Standard Clause in Part C:8 (*General Obligations: Warranties*).

[155] This refers to the Clauses dealing with Compensation Events.

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(ii) be responsible for and it indemnifies the Institution against all direct losses sustained by the Institution in consequence of cleaning-up and otherwise dealing with any potentially hazardous materials (being any natural or artificial substance, whether in solid, gaseous or liquid form capable of causing harm to any human or any other living organism supported by the environment (including air, water, land, surface land and sub-surface land) or capable of damaging the environment or public health or posing a threat to public safety including any pollutants and any hazardous, toxic, radioactive, noxious, corrosive or dangerous substances and all substances for which in each case liability or responsibility is imposed under applicable environment law) at the Project Site.[156]

12.2 Latent Defects[157]

12.2.1 In a Project involving the construction of new buildings and/or infrastructure by or on behalf of the Private Party, the Private Party should bear the design and construction risk in respect of those Facilities as well as the risk of latent defects in those Facilities.

12.2.2 In Projects involving the take-over and upgrading or refurbishment of an existing building and/or infrastructure to be utilised by the Private Party in the provision of the Services,[158] where there is no construction guarantee from the original building contractor or such guarantee is insufficient or not transferable to the Private Party, the Institution may be expected to assume the risk of latent defects in the existing building and/or infrastructure.

12.2.3 The Institution should, however, not readily assume such risk. Instead, whether or not this risk should be assumed by the Institution should be decided on a project-by-project basis having regard to the particular

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[156] If the Institution has agreed (in accordance with Part C:9 (*General Obligations: Indemnities and Claims for Damages*)) to cap the Private Party's liability then this Standard Clause must be amended as appropriate.

[157] See also Part C:8 (*General Obligations: Warranties*).

[158] Compare this with a project involving the take-over by the Private Party of existing buildings or infrastructure for its own commercial purposes and not for the performance of an institutional function on behalf of the Institution.

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circumstances of the Project, including, for example, the length of time for which the existing building or infrastructure has been operational. This decision should always depend on whether the Institution's assumption of such risk will provide better value for money. Thus, for example, an Institution should not readily assume this risk in respect of the structural stability of an existing building or infrastructure that has been operational for a lengthy period without any indication whatsoever of structural instability. On the other hand, where the existing building or infrastructure has not been operational for any substantial period of time and, accordingly, its structural stability has not really been "time tested", the Institution should expect to assume some of this risk (save to the extent that any construction guarantees are still in effect and can be transferred to the Private Party). The sharing of this risk between the Parties may also vary in relation to different parts of the existing building or infrastructure as certain parts may be perceived as having lesser risk of latent defects than other parts.

12.2.4 The Institution should also not assume the risk of latent defects in the Project Site itself (for instance, in relation to subsidence, seismic instability, environmental contamination and so forth). However, in the case of a Project Site to be used by the Private Party in the provision of Services[159] where, because of the nature of historical activities at the Project Site, there is a high risk of environmental contamination at the Project Site, the transfer of the full risk of latent environmental contamination to the Private Party may not result in value for money for the Institution. In such cases, if better value for money will be attained thereby, then the Institution should assume the risk of latent

[159] Compare this with a project involving the take-over by the Private Party of a Project Site for its own commercial purposes and not for the performance of an institutional function on behalf of the Institution.

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environmental contamination at the Project Site up to the Signature Date.[160]

12.2.5 If an Institution does assume any latent defect risk, it should ensure that the Private Party is under a clear obligation to mitigate the potential effects of this risk. The Institution should also implement (if practicable) the following mitigation measures:

12.2.5.1 it should make the results of all surveys commissioned by it in respect of the Project Site (including existing buildings and infrastructure) available to all the bidders;

12.2.5.2 all the bidders should be given a reasonable opportunity to conduct a thorough investigation of the Project Site (including existing buildings and infrastructure) in order to maximise the possibility of exposure of defects and the extent of any required remediation, although the Institution should be cognisant of the practical difficulties bidders may face in undertaking their investigations on the Project Site where existing buildings and infrastructure are to be retained for the provision of the Services;

12.2.5.3 prior agreement should be reached between the Parties on the scope of the remediation works that will be required to be undertaken to fix identified defects to the satisfaction of the Private Party;[161]

12.2.5.4 the cost of the remedial works for identified defects should be pre-agreed. Any such costs paid for by the Institution must be

[160] See Section 14.2 *(Environmental Risks)*.

[161] Here the Institution should not be tempted to be prescriptive regarding the remediation works as the risk of implementing such works should be shifted to the Private Party in the PPP Agreement.

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certified by the Private Party as being sufficient to remove these defects to the satisfaction of the Private Party;

12.2.5.5 the liability of the Institution in relation to latent defects should not be capped if this is necessary to achieve affordable bid prices (as bidders will usually price for the cap through higher bid prices) and value for money for the Institution. It should not, however, be readily assumed that an uncapped liability will necessarily ensure better value for money. Further, the Institution's liability should not be triggered in respect of minor defects discovered after the Signature Date. In other words, the Institution should consider whether value for money requires that its liability be subject to a "floor" (in addition to any cap or no cap); and

12.2.5.6 the Private Party should be under an ongoing obligation to report on the condition of the Project Site and the discovery of latent defects.

12.2.6 The Institution should appoint an independent expert to monitor and report on the bidders' investigations referred to in Section 12.2.5.2 above in order to ensure that these investigations are reasonably thorough. Furthermore, the independent expert should be mandated to monitor and report on the implementation of the remediation works agreed to between the Parties and certify the completion of these works. The principles referred to in Part E:19.2 to Part E: 19.4 (*Duration and Service Commencement: Independent Certifier*) in relation to the appointment and duties of, and the limitations on the risks assumed by, the Independent Certifier must apply to the same extent to the independent expert appointed in respect of the remediation works.

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13 PLANNING CONSENTS AND RISKS

13.1 In this Standardisation, "planning risks" refers to the possibility that the proposed use of the Project Site in terms of the PPP Agreement and, in particular, the construction of the Facilities on the Project Site, will fail to comply with any applicable laws relating to planning, land-use or building (for example, any town-planning or land zoning scheme[162]) or any Consent required to be obtained pursuant thereto, or that any such Consent will be delayed or cannot be obtained or, if obtained, can only be implemented at a greater cost than originally projected.

13.2 Save as provided in Section 13.5, the prescribed approach in respect of PPPs is that planning risks should be allocated between the Parties as follows:

13.2.1 unless the selection of the Project Site is the responsibility of the Private Party, the Institution should be responsible for obtaining any zoning, re-zoning and/or land-use Consents required for the Project Site.[163] This should be done at the time of the feasibility study phase of the Project and not after the Project has been put out to tender. (The costs of these Consents should be included in the affordability assessment to be submitted to the Approving Authority for approval of the Project);

13.2.2 the Private Party should be responsible for identifying and obtaining all planning and building Consents required in connection with the design and/or construction of the Works. The Private Party should make adequate provision for this in its Works programme;[164] and

[162] These will include building codes and bye-laws of other Responsible Authorities where the Project Site extends to areas beyond those owned by the Institution itself.

[163] The Institution should ensure that the proposed development is in line with the macro-planning policies of any Responsible Authorities having planning jurisdiction over any portion of the proposed Project Site, such as the Integrated Development Plans of any municipalities having jurisdiction.

[164] It is common practice in the construction industry for building contractors to incorporate contingencies into their construction contracts to provide for delays in obtaining any necessary planning Consents.

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13.2.3 the Private Party must be responsible for implementing all planning, land-use and building Consents issued in respect of the Project, and complying with all applicable planning, land-use and building laws. The cost of doing so is for the Private Party.

13.3 The obtaining of any of the Consents in Section 13.2.2 by the applicable milestone dates in the Private Party's Works programme must not be a condition suspending the enforceability of the PPP Agreement. In addition, the Private Party's failure to obtain any such Consent by the applicable milestone date should not result in the termination or cancellation of the PPP Agreement (that is, it should not be a resolutive condition) nor should it be treated as a Compensation Event. This is because to do otherwise will result in the Institution taking back the design and construction risks.

13.4 However, if the grant of any such Consent is delayed because of circumstances beyond the control of the Private Party or the Subcontractors, then such delay may be treated as a Relief Event.[165]

Standard Clause[166]

Private Party Consents

(a) The Private Party shall be responsible for:

(i) obtaining all Consents [(other than those listed in Schedule [x])][167] which may be required in connection with the performance of the Project Deliverables;

(ii) maintaining in full force and effect all Consents [(including those listed in Schedule [x])][168]; and

165 Accordingly, although the Private Party will get relief from termination for such a delay, it will retain the financial risks associated with such delay (save to the extent that its losses arising from such delay are covered by its project delay insurance). Any debt service due and payable in the period of the delay should be covered by the reserves in the Private Party's debt service reserve account.

166 This Standard Clause applies to any planning, building, environmental and any other Consents required for the performance of the Project Deliverables.

167 This Schedule should list all those Consents that have or will be obtained by the Institution as contemplated in Section 13.2.1 and Section 14.1.1.

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(iii) implementing all Consents [(including those listed in Schedule [x])][169] in accordance with their respective terms within the period of their validity.

(b) The Institution shall provide all such assistance to the Private Party as may be reasonably necessary for the Private Party to obtain all the Consents referred to in Clause (a)(i); provided, however, that the Institution shall incur no liability for the costs of obtaining or maintaining, or any delay, failure or inability of the Private Party to obtain or maintain any such Consents.

13.5 In a PPP where the Private Party will not perform any institutional function but will use state property made available by the Institution solely for its own commercial purposes, all planning risks are for the Private Party.

14 ENVIRONMENTAL CONSENTS AND RISKS

The Private Party is responsible for obtaining all environmental consents required for, and must assume all environmental risks (including for pre-existing environmental contamination) associated with, a PPP where the Private Party will not perform any institutional function on behalf of the Institution but will use state property made available by the Institution solely for its own commercial purposes.

14.1 Environmental Consents

14.1.1 In Projects involving the performance by the Private Party of an institutional function, the Institution should be responsible (at its cost) for conducting any macro-level environmental impact investigation into, assessment of, and reporting to the Responsible Authorities, on the proposed land uses and activities at the Project Site, to the extent required under the Pakistan Environmental Protection Act, 1997[170] ("PEPA") unless the selection of the Project Site is the responsibility of the Private Party. Such costs should be reflected in the affordability assessment

[168] See footnote 167.

[169] See footnote 167.

[170] And the requirements of respective Provincial Environment Protection Legislation

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included in the feasibility study for the PPP that will be submitted to the Approving Authority for the approval of the Project.[171]

14.1.2 The Institution should not put such a Project out to tender until the macro-level environmental investigations into the potential impact of the proposed land uses and activities on the environment have been completed and discussed with the Federal or the Provincial Environmental Protection Agencies (as applicable). Further, any concerns raised by the Environment Protection Agencies in response to such report should be dealt with by the Institution in advance of the tender to reduce the scope for any delays in the tender process (and implementation of the Project after the award of the tender) arising from the potential environmental impact of the Project. In projects where funding by multilateral or bilateral donor or development organisations is expected, close attention must be paid to their environmental policies and the Project structure should take into account such policies.

14.1.3 On the other hand, the responsibility for conducting any scoping and EIA required pursuant to the PEPA for any project should be borne by the Private Party since the EIA is dependent on the design and construction specifications of the Works for which the Private Party is responsible. The Private Party must generally assume all risks associated with any such EIA and should adequately provide in its Works programme for the time it will require to conduct and obtain a record of decision in relation to the EIA. Accordingly, the issue by the Environment Protection

[171] The construction of a new road through a forest, a new airport and a new prison in areas where there are no similar developments are examples of developments where a macro-level investigation (sometimes referred to as a "**Strategic Environmental Assessment**" or "**SEA**") has to be undertaken to ascertain the cumulative environmental impacts of the proposed development for the general area in which the proposed development will be located. By comparison to an EIA, the SEA is not directed to the specific design parameters of the proposed development and the immediate impact thereof on the environment at the specific location of the proposed development. However, an SEA can contribute significantly to the timeous and successful implementation of a Project by reducing the time and effort entailed by an EIA. For instance, if an SEA determines that the proposed route of a new road will have a cumulative detrimental impact on the environment and this determination is made before the Project is put out to tender, the Institution will avoid the wasted time and costs that will arise if the SEA is not undertaken but a similar determination is made pursuant to the EIA undertaken by the Private Party.

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Agencies of a favourable record of decision on the EIA should not be a suspensive condition of the PPP Agreement. In addition, the Private Party's (or the Construction Subcontractor's) failure to obtain such decision should not result in the termination or cancellation of the PPP Agreement (that is, it should not be a resolutive condition) nor should it be treated as a Compensation Event. This is because to do otherwise will result in the Institution taking back the design and construction risks. However, a delay in the issue of the record of decision by the applicable milestone date in the Works programme should be a Relief Event (thereby giving the Private Party relief from termination, but not from the financial costs of such delay)[172], but only if this delay arises because of circumstances beyond the control of the Private Party or the Subcontractors.

14.2 Environmental Risks

14.2.1 The Private Party should bear all environmental risks associated with the performance or non-performance of the Project Deliverables, and should be liable for any risk of environmental damage to the Project Site or third party property arising in connection with such performance or non-performance.

14.2.2 If there is a risk of environmental contamination at the Project Site caused by activities conducted at the Project Site or on adjacent sites before the date on which control of the Project Site is transferred to the Private Party, then the Institution should consider the value for money benefits of compensating the Private Party by way of an indemnity for the direct losses incurred by the Private Party in connection with such contamination. Such indemnity should, however, only extend to any

[172] Any debt service becoming due and payable over the period of the delay should be covered by the reserves in the Private Party's debt service reserve account.

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latent pre-transfer environmental contamination discovered within a specified period after the Signature Date. What that period should be, should be determined by the Institution on a project-by-project basis having regard to value for money considerations.

14.2.3 The Private Party may also seek to be indemnified against the losses incurred by it as a result of future environmental contamination at the Project Site arising from ongoing activities at adjacent sites. As between the Institution and the Private Party, the Institution must not assume the risk of such activities and, accordingly, it may not grant any indemnities (or any other compensation) to the Private Party in this regard. The Private Party will have recourse (under the Pakistan Penal Code, common law and PEPA) against the polluter and should rely on the remedies available to it under these laws to recover any such losses.

14.2.4 If the Project involves the take over by the Private Party of existing buildings and/or infrastructure which are likely to have caused or contributed to pre-transfer environmental contamination at the Project Site, the Private Party will be exposed to the risk that these may be closed down or the Services compulsorily ceased or adversely restricted by an Environment Protection Agency (or another Responsible Authority) in order to stop the continuation of such contamination. The Private Party (and its funders) may seek to be indemnified against the losses incurred by it as a result of such closure, cessation or adverse restriction.

14.2.5 Any indemnities granted by the Institution (whether in the circumstances contemplated in Section 14.2.2 or Section 14.2.4) must be subject to the limitations discussed in Part C:9 (*General Obligations: Indemnities and Claims for Damages*) and Part C:10 (*General Obligations: Double Recovery and Mitigation*). The PPP Agreement must set forth a procedure for the Private Party to notify the Institution of the discovery

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after the Signature Date of any pre-transfer environmental contamination, for the Private Party to present a proposal to the Institution for the remediation of such contamination (including an estimate of the reasonable costs of the remediation works) and for the Parties to negotiate the terms of that proposal. It must also provide for the referral of any disputes in connection with such contamination and the Private Party's remediation proposal to the independent expert referred to in Section 14.2.9. Once the remediation proposal has been agreed (or, if applicable, determined by the independent expert), the Private Party should bear the risks associated with the contamination save for the costs of the remediation works, as agreed or determined by the independent expert, which must be borne by the Institution.

14.2.6 If an Institution wishes to limit the scope of or otherwise avoid the grant by it of any indemnities for latent pre-transfer environmental contamination, then it should during the feasibility study phase commission (at its own cost) environmental surveys of the nature and extent of the on-site contamination and, if feasible, incorporate the remediation of the Project Site into the Project Deliverables and, accordingly, into the output specifications for the Project. The full results of these surveys must be incorporated in the RFP documents and the bidders must be specifically requested to submit proposals for the remediation of the Project Site and to price separately for the costs of such remediation. The bidders should also be required to conduct their own environmental investigation of the Project Site in order to satisfy themselves as to the nature and extent of the on-site contamination identified by the Institution and appropriateness of any remediation works proposed by them. In setting the output specifications for the remediation of the Project Site, the Institution should bear in mind that the minimum legal standard for the remediation of any contamination

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may not be sufficient for the proper performance of the other Project Deliverables. For example, if the minimum legal standard for the remediation of any environmental contamination is containment as opposed to the removal of the contamination, the Institution should not limit the output to containment, simply because this is less expensive than removal, if the removal of the contamination is necessary for the proper performance of the remaining Project Deliverables. In this regard, the Institution should bear in mind that the minimum legal standards are also likely to fall short of Good Industry Practice with which the Private Party is obliged to comply in the performance of the Project Deliverables.

14.2.7 To avoid the assumption of any risks in respect of the scope and quality of remediation works, the Institution should not be prescriptive regarding the scope or nature of the remediation works, or how such works must be carried out. The Parties must, however, pre-agree the date by when such remediation works must be concluded. The Private Party's remediation programme for the remediation works contemplated in Section 14.2.6 must be incorporated into its Works programme.

14.2.8 The cost of the remediation works in respect of any pre-transfer environmental contamination discovered before the Signature Date and identified in the environmental remediation output specifications, must be pre-agreed and fixed in the PPP Agreement. This will serve to cap the Institution's liability in respect of such contamination.

14.2.9 The Institution should consider appointing an independent expert to monitor and report on the implementation by the Private Party of its proposed remediation works. The independent expert must also be mandated to certify the completion of the remediation works. The principles referred to in Part E:19.2 to E:19.4 (*Duration and Service Commencement: Independent Certifier*) in relation to the appointment

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and duties of, and the limitations on the risks assumed by, the Independent Certifier must apply to the same extent to the independent expert appointed in respect of the remediation works.

14.2.10 The Institution should, at the feasibility phase, consider whether the remediation works should be funded through a capital contribution made at the commencement or completion of those works, or through the User Charges. The choice of payment option will depend on which option provides better value for money. In order to test the value for money benefits of each payment option, the Institution should consider requesting the bidders to bid on all payment options. Since the User Charges only commence once the Services are available, the delay of the payment for the remediation works until then (and its "amortisation" over the whole or part of the Service Period) may not satisfy the cash flow needs of the Private Party.

14.2.11 It is important that the Institution does *not* permit the issue of pre-transfer environmental contamination to cloud the issue of the Private Party's responsibility for environmental risks arising in connection with the performance or non-performance of those Project Deliverables that are unrelated to the remediation of any pre-transfer environmental contamination. In this regard the Institution should ensure that the environmental risks associated with the ordinary operational obligations of the Private Party are not transferred to the Institution through any indemnities given by it in respect of latent pre-transfer contamination or the provisions of the PPP Agreement in respect of identified pre-transfer environmental contamination. The Institution should be particularly concerned that funds allocated for agreed environmental remediation works are not utilised to fund the ordinary operation and maintenance obligations of the Private Party.

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15 HERITAGE RESOURCES

15.1 The Private Party must comply with all applicable legislation relating to heritage resources in the performance of the Project Deliverables, for example, the National Fund for Cultural Heritage Act, 1994, and Sindh Cultural Heritage (Preservation) Act, 1994.

15.2 The bidders' site condition investigations must include an investigation of the age and heritage status of all existing buildings and infrastructure at the Project Site. The discovery after the Signature Date that any building or infrastructure at the Project Site is a protected heritage resource and any resultant delays in the Works required for the Project must be neither a Relief Event nor a Compensation Event.

15.3 The bidders' investigations into ground and subsurface conditions at the Project Site must extend to any palaeontological and archaeological conditions. The discovery after the Signature Date of any heritage resource (such as burial grounds of cultural significance) that could have been discovered through the exercise of reasonable due diligence on the part of the Private Party in the course of its investigations should not be a Relief Event or a Compensation Event. The discovery after the Signature Date of any heritage resource that could not be discovered through the exercise of reasonable due diligence by the Private Party should be treated as a Relief Event entitling the Private Party to an extension of time, but (save as contemplated in Section 15.4) the financial risks associated with such discovery must be borne by the Private Party. In this regard, see Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*).

15.4 If the discovery of any heritage resource entitles the Private Party to any relief as aforesaid and the Private Party is instructed to undertake any additional works or variation in the Works in connection with such discovery, then the

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Private Party will be entitled to compensation for such works (which shall be deemed to be an Institution Variation) in terms of the provisions dealing with Institution Variations. If the Private Party is not entitled to any relief as aforesaid, then the additional works or variation in the Works shall be deemed to be a Private Party Variation.

15.5 If any heritage resources are discovered in the course of the surveys commissioned by the Institution at the feasibility study phase, or any investigation conducted by a bidder, then the Institution should endeavour to obtain any necessary Consents for the proposed PPP development from the Responsible Authority before the commencement of the procurement phase (in the case of discoveries made in the feasibility phase) or the Signature Date (in the case of discoveries made in the bid phase). After any such discovery, the Institution should first assess the cost implications for the Project of any actions required by such Responsible Authority in relation to such discovery before proceeding with the Project (or the procurement thereof).

Standard Clause

Heritage Objects and Resources

(a) *Discovery*

Upon the discovery of any heritage object or resource (as defined in the National Fund for Heritage Act, 1994 / Sindh Cultural Heritage (Preservation Act, 1994 or any corresponding legislation) during the course of the Works, the Private Party shall:

(i) *promptly notify the Institution of such discovery;*

(ii) *take all necessary steps not to disturb the heritage object or resource, including cease any Works to the extent that the carrying out of such Works might reasonably endanger the heritage object or resource or prevent or impede its excavation or preservation; and*

(iii) *take all necessary steps to preserve the heritage object or resource in the same position and condition in which it was discovered.*

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(b) Action

(i) The Institution shall promptly and in any event within [x] Business Days of the notice in section (a)(i) issue an instruction to the Private Party specifying what action the Institution requires the Private Party to take in relation to such discovery.

(ii) The Private Party shall promptly and diligently comply with any instruction so issued (save to the extent that such instruction constitutes a proposal by the Institution for a deemed Institution Variation as provided in Clause (iv) below, in which case the variation procedure provided for in Clause [x] (Institution Variations) shall apply)[173] *at its own cost.*

(iii) If so directed by the Institution or Responsible Authority, the Private Party shall allow representatives of the Institution or Responsible Authority to enter onto the Project Site for the purposes of removal or disposal of such discovery; provided that such entry shall be subject to the Institution or Responsible Authority complying with all relevant safety procedures which shall include any relevant health and safety plans for the construction of the Facilities and any reasonable directions regarding the safety of the Project Site that may be issued by or on behalf of the Private Party.

(iv) If the discovery is a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities) which are not Works that would be necessary for the purpose of compliance with applicable law or any Consents, then such works shall be deemed to be an Institution Variation and the provisions of Clause [x] (Institution Variation) shall apply.

(v) If the discovery is not a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities), then such works shall be deemed to be a Private Party Variation and the provisions of Clause [x] (Private Party Variation) shall apply.

[173] In this regard, see Part K: 50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

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16 UTILITIES AND RESOURCES

16.1 In this Standardisation, "utilities supply risk" refers to the possibility that any utilities such as water, electricity or gas that will be required for any part of the Project Deliverables (not limited to the construction Works) may not be available. Generally, the utilities supply risk should be borne by the Private Party.

16.2 One exception here is where the supply of any such utilities falls within the functional competence of the Institution.

16.3 In addition, where the location of the Project Site is critical (such as the location of a prison) and any required utilities are not available in the vicinity of the Project Site, the Institution may share in some of the utilities supply risks if and to the extent that this will result in better value for money. The value for money benefits of the Institution sharing in these risks should be determined at the time when the feasibility study is undertaken. The Institution should ensure that the RFP clearly stipulates how the utilities supply risk will be allocated as between the Parties so that the Institution can consider how the bidders have priced for that portion of the risk that will be allocated to the Private Party and how such allocation impacts on affordability and value for money.

16.4 This risk-sharing may involve the provision by the Institution (at its cost) of all required connections for the supply of utilities up to the boundary of the Project Site, and the provision of all connections to the Facilities from the boundary of the Project Site by the Private Party (at its cost). The Institution should bear in mind that if it undertakes to provide any required connections for the supply of utilities, a delay by it in the provision of these connections might impact on the Works programme of the Private Party and ultimately the Service Commencement Date. Such delay may have to be treated as a Relief

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Event. It may even be treated as a Compensation Event, unless project delay insurance is available to cover this risk.[174] In such circumstances, the Institution should also not be entitled to call on its security (if any) against late Service Commencement.

16.5 Generally, the Institution should not, whether in the circumstances contemplated in Section 16.4 or otherwise, assume any ongoing responsibility for the supply of the utilities after the required connections become operational. Thus off-site and on-site interruptions[175] in the supply of utilities after the required connections become operational should be at the Private Party's risk and should not be treated as Compensation Events (nor should the Institution indemnify the Private Party for losses incurred by it as a result of such interruptions), although the Private Party should get relief from termination in relation to off-site interruptions arising from circumstances beyond its control (that is, such interruptions should be treated as Relief Events).

16.6 If, however, value for money considerations require the Institution to bear some of the risk of interruptions in the utilities supply, this risk may be borne by the Institution but only in relation to off-site interruptions and then only to the extent of an interruption in the performance of the Project Deliverables, by way of relief from Penalty Deductions. In considering whether or not to grant such relief, the Institution should bear in mind that the Private Party's revenue losses arising in connection with interruptions in the supply of utilities might be covered by the project delay or business interruption insurance to be maintained for the Project. The Institution should obtain specific advice on this issue from its insurance advisor.

[174] See Part J: (*Relief Events, Compensation Events and Force Majeure*).

[175] The term "interruption" includes both a failure in the supply of utilities and a shortage in the required volumes of supply.

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16.7 Another risk associated with utilities is the risk of delays arising in connection with the removal and relocation of utilities located at the Project Site, for instance, electricity supply lines and associated infrastructure. The erection of construction Works on a Project Site may necessitate the removal and relocation of existing utilities. This is typically undertaken by the utility supplier. Unless the Institution is also the utility supplier, this risk should be borne by the Private Party. Where, however, these delays are not attributable to the Private Party, then relief may be granted in the event that Service Commencement is delayed by these delays. Such relief will be in the form of Relief Events and relief from calls by the Institution on its security (if any) against late Service Commencement.

16.8 The input or resource risk (that is, the possibility of a failure in the supply of inputs or resources (for instance, coal and other fuels) required for any Project Deliverables, including any deficiencies in the quantities and quality of such inputs or resources) should generally be borne by the Private Party.

16.9 However, where the Institution is the supplier of such inputs or resources then this risk should be borne by the Institution. In addition, any failure or shortage in the supply of required resources that arises because of circumstances beyond the control of the Private Party should be treated as a Relief Event.

16.10 To mitigate against this risk, the Private Party may enter into "requirements contracts" (often on a "take-and-pay" basis)[176] with suppliers pursuant to which the suppliers (in turn) will assume the risk of any failure in the supply by agreeing to meet the full supply requirements of the Private Party from time to time and to indemnify the Private Party against losses sustained by it if these requirements are not supplied. These contracts should be included in the Project Documents and be reviewed by the Institution in light of the

[176] Meaning that the Private Party's obligation to pay for any inputs supplied is conditional upon delivery of the required inputs.

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considerations mentioned in Part B: (*Project Documents and Project Deliverables*).

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PART E: DURATION AND SERVICE COMMENCEMENT

17 DURATION

17.1 The PPP Agreement must specify its duration. A distinction may need to be made between the period (if any) from the Signature Date to the commencement of the Service Period, and the Service Period itself. It may also be appropriate to specify a "Long Stop Date" for the commencement of the Services, non-fulfilment of which may amount to a breach of the PPP Agreement entitling the Institution to terminate the PPP Agreement.[177]

17.2 The choice of duration should be considered in light of the following factors:

17.2.1 the requirements placed by the underlying Institutional function in relation to the Services;

17.2.2 the possibility of alternative uses of the Project Assets;

17.2.3 the affordability of the Services for the end users (and, in Hybrid PPPs, for the Institution in light of its anticipated future budgetary allocations) and also the expected useful economic life of the Project Assets. Here, the basic principle is that a longer duration PPP Agreement may be more affordable as this may reduce the amount of the User Charges over the Project Term;

17.2.4 the need for any major refurbishment or replacement programmes in respect of the Project Assets over the Project Term; and

17.2.5 the term of the Debt (a longer debt service period could allow a longer duration).

17.3 One factor influencing a shorter Project Term is where the Project Assets have an alternative use so that the Private Party would be able to recover a portion of the cost

[177] As the ultimate goal of the Institution is Service Commencement and not termination it is important that the need for a Long Stop Date be carefully considered particularly in relation to value for money. This issue should be considered at the feasibility study phase..

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of financing its investment in the Project by putting such Project Assets to an alternative use or selling them after the Expiry Date. Here the User Charges should be lower and the Project Term should be shorter than would be the case if the Project Assets had no alternative use. This assumes, however, that the Institution will not require the Project Assets after the Expiry Date in order to provide (either itself or through a third party) services similar to the Services. If the Institution requires the Project Assets, their alternative uses will not be a relevant consideration.

17.4 If there is a substantial risk of technical obsolescence resulting from rapid technological changes or changes in the functional requirements for the Project, with the result that the Services may become redundant before the Expiry Date, then the Institution may wish to negotiate for some flexibility for a shorter Project Term. The implications of such flexibility for the affordability of the Project and its anticipated value for money will have to be assessed on a project-by-project basis.

17.5 A number of events, particularly Relief Events, will have a significant impact on the Service Commencement Date as well as the timing of the Service Commencement Date. See Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*). Relief Events should not lead to an extension of the Project Term.

Standard Clause

Duration of PPP Agreement

(a) This PPP Agreement and the rights and obligations of the Parties under this PPP Agreement shall take effect on the Signature Date.[178]

(b) The Service Period shall commence on the Service Commencement Date and terminate on the earlier of the Expiry Date and the Termination Date.

[178] See Part A:3 (*Preliminary: Conditions*). If the PPP Agreement is conditional, then this standard Clause (a) will need to be amended as appropriate.

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18 DESIGN RISK AND SERVICE COMMENCEMENT

18.1 Introduction

18.1.1 It is assumed in this Standardisation that the PPP Agreement will provide for a construction or development phase from the Signature Date to the Service Commencement Date, during which period the Private Party will carry out its construction or development obligations included in the Project Deliverables.

18.1.2 The Institution should satisfy itself during its evaluation of the Private Party's bid and the negotiations on the PPP Agreement (and in any event prior to the Signature Date), that the Private Party's design proposals included in its bid will achieve the required output specifications as set forth in the RFP. Design proposals submitted at the bid stage are typically conceptual in nature and are more often than not substantially modified prior to the Signature Date. The Institution should ensure that the Private Party's design proposal that is current at the Signature Date is incorporated into the PPP Agreement. This is usually the preliminary design as the detailed design is almost always finalised after the Signature Date and should be subject to review by the Institution. Accordingly, the PPP Agreement should be sufficiently flexible to allow for changes and improvements to the preliminary design in order to allow for any planning, environmental or other requirements. The Private Party must be solely responsible for the design and, while the Institution should have a right to review the design, the Institution should have no rights of approval in respect of the design. Accordingly, all changes in the design in order to ensure that the output specifications are met or that all Consents are obtained or adhered to, should be at the risk of the Private Party. The Institution will want the reassurance that the construction or development will be capable of delivering the Services on time and in a way that meets the Institution's output specifications in the PPP Agreement. Conversely, the Private Party will not want to be "micro-managed", although it may want some reassurance that what

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it is constructing or developing will meet the required output specifications. This reassurance and objectivity is provided to both the Institution and the Private Party by the Independent Certifier who will inspect the completed Works and if satisfied will issue the Completion Certificate. While the Institution must be entitled to monitor the Works during the construction or development phase, it should not have any approval rights in respect of the Works. The ultimate risk and responsibility for the Works is with the Private Party who, once the Independent Certifier has issued the Completion Certificate, will issue the Availability Certificate certifying Service Commencement.

18.1.3 The prescribed approach in this Standardisation in relation to design risks (that is, the possibility that the design of the Facilities to be constructed or developed may not achieve the required output specifications) is that such risks should be borne by the Private Party. Accordingly, the key issue is the extent to which the Institution should be involved during the construction or development phase and what rights, if any, it should have to monitor and review the Private Party's progress.

18.1.4 After the Signature Date, but prior to the Service Commencement Date, the role of the Institution should include:

18.1.4.1 reviewing and commenting on (but not approving) any changes and further developments in the Private Party's design. The costs of changes to the design should be borne by the Private Party. As the Institution should have no right to veto any changes to the design, the PPP Agreement should clearly stipulate that any review and comment by the Institution will not excuse the Private Party from any liability in respect of the design;

18.1.4.2 reviewing and observing tests of any equipment being developed;

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18.1.4.3 reviewing the Private Party's activities in accordance with the quality management system of the Private Party, which must be pre-agreed and incorporated into the PPP Agreement.

18.1.5 The Institution's role, therefore, is confined to the Institution reassuring itself that the delivery programme is on track and that any overriding safety issues will be satisfactorily addressed. The PPP Agreement provisions dealing with the Institution's access to information and to the Project Site during the construction or development phase should be drafted to provide for the limited scope required by the Institution, unless the Institution requires greater access to fulfil a statutory duty or comply with a statutory function.

Standard Clause

Project Design

The Private Party shall remain solely responsible for ensuring that the Project as designed and developed is suitable for the delivery of the Services, for ensuring that the Services are implemented in accordance with this Agreement and that the [service levels] [output specifications] are achieved during the Service Period. No rights of estoppel or waiver shall arise as a result of the review by the Institution of the design of the Project and any changes thereto.

19 INDEPENDENT CERTIFIER

19.1 Introduction

The Independent Certifier is an expert[179] who will be responsible for certifying that, in its professional opinion, the Works have been satisfactorily completed in terms of the PPP Agreement, by issuing the Completion Certificate. Once the Completion

[179] Depending on the nature of the Project, the area of expertise of the expert will vary. In construction contracts this will be a person with construction experience.

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Certificate has been issued the Private Party may immediately thereafter issue the Availability Certificate signalling Service Commencement. The PPP Agreement must, however, clearly stipulate any necessary liaison procedures between the Institution and the Private Party in order to ensure that the Institution is aware of the imminent Service Commencement and is in a position to accept Service Commencement on the Service Commencement Date.

19.2 Appointment

The Independent Certifier should be appointed by the Private Party, subject to the prior approval of the Institution. The Independent Certifier should have a duty of care to both the Private Party and the Institution. The Private Party should, however, be responsible for payment of the Independent Certifier's fees. The PPP Agreement and the contract for the appointment of the Independent Certified should clearly stipulate that the fact that the Independent Certifier is paid by the Private Party does not in any way derogate from its fiduciary duty to the Institution.

19.3 Duties

19.3.1 The primary function of the Independent Certifier is to inspect and monitor the Works, attend any performance testing during commissioning, advise the Private Party of any items that in the Independent Certifier's opinion require rectification and, finally, when satisfied, to issue the Completion Certificate.

19.3.2 It is essential that the terms of reference for the appointment of the Independent Certifier be agreed between the Parties and the Independent Certifier. It is advisable for this to be included in a separate agreement which should clearly stipulate the role of the Independent Certifier.[180]

[180] This contract must be included in the Project Documents for the Project.

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19.4 Risk

The Independent Certifier is appointed to provide a reasonable and objective measure of ensuring that the Private Party completes the Works in accordance with the PPP Agreement. In performing its functions, the Independent Certifier does not in any way acquire any risk in relation to the design, construction, fitting, installation or commissioning of the Works. The PPP Agreement must clearly stipulate that the risk remains with the Private Party.

20 ACCEPTANCE AND SERVICE COMMENCEMENT

20.1 New Services

20.1.1 Before Service Commencement, the Private Party should be obliged to demonstrate that the Facilities will meet the required output specifications. The method of demonstration to be used by the Private Party will be project-specific but may take the form of inspections, demonstrations, acceptance or commissioning trials or other performance tests.

20.1.2 The PPP Agreement should set out in detail:

20.1.2.1 the provision by the Private Party to the Independent Certifier and the Institution of adequate prior notice of any performance test;

20.1.2.2 the rights of the Institution and the Independent Certifier to access the Project Site to witness the performance tests where the Institution does not otherwise have access to the Project Site;

20.1.2.3 the documents required to evidence the results of the performance tests;

20.1.2.4 that the Independent Certifier shall be responsible for assessing the success or failure of the performance tests;

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20.1.2.5 the procedure for the Private Party to remedy any defects that result in a failure to pass any such performance test as notified by the Independent Certifier;

20.1.2.6 the consequences for the Private Party of a failure to remedy any such defects. This will usually result in the Independent Certifier not issuing the Completion Certificate, the Private Party therefore not being able to issue the Availability Certificate, the Services not commencing and the User Charges not becoming due; and

20.1.2.7 if the results of the performance tests are satisfactory to the Independent Certifier, the timing and procedure for issuance of a Completion Certificate by the Independent Certifier indicating acceptance that the Works have been completed in accordance with the terms of the PPP Agreement.

20.1.3 Only once the Independent Certifier has issued the Completion Certificate should the Private Party be entitled to issue the Availability Certificate declaring the Service Commencement Date. The Completion Certificate is a pre-requisite for the issuing of the Availability Certificate. Once the Completion Certificate has been issued and the Institution is ready to accept Service Commencement pursuant to the terms of the PPP Agreement[181], the Private Party may issue the Availability Certificate. Once the Availability Certificate has been issued by the Private Party, the Services are deemed to be available and the User Charges can be billed by the Private Party from that date, being the Service Commencement Date.

20.1.4 The Institution should generally not seek to impose pre-Service Commencement milestones in the construction or development phase or otherwise accept the delivery of the Works in stages prior to Service

[181] See Section **Error! Reference source not found.**.

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Commencement as this may reverse the prescribed allocation of risk.[182] Ideally the Independent Certifier should not be entitled to accept incomplete construction for the purposes of issuing the Completion Certificate. This may affect the risk transfer as the Private Party may seek a waiver of Penalty Deductions, certain indemnities against loss due to injuries that may be suffered as a result of the use of an incomplete Facility, as well as payment of the Unitary Payment. In certain PPPs, however, it may be appropriate to have Service Commencement, despite incomplete construction.[183] Here the Institution must, however, ensure that the Private Party always remains "incentivised" (through the payment mechanism)[184] to complete the outstanding Works.[185]

20.1.5 In certain PPPs it may be feasible to have phased-in Service Commencement[186] (that is, different buildings or sections or different pieces of plant and equipment being brought into service at different milestones in the PPP) in which event an appropriate phasing-in of the Services and corresponding User Charges may be justified. In such cases, the Institution may either:

20.1.5.1 stipulate that full Service Commencement will only be achieved when all phases in the Project reach the required output specification level, which would incentivise the Private Party to bring them all up to the required output specification levels as quickly as possible; or

20.1.5.2 stipulate that partial Service Commencement will be achieved as each phase reaches the output specification level for the Services being provided, so that User Charges reflect the Services actually available.

[182] In projects that are partly funded by means of a capital contribution by the Institution or other government entity, it may be necessary to provide for the achievement of construction milestones when capital contribution payments will be made to the Private Party.

[183] For example, in an accommodation project the Institution may accept Service Commencement where certain aspects of the Works (such as, landscaping) are not completed, as long as these are not integral to the Private Party's ability to provide the main Services.

[184] See Part F:23 (*Services*).

[185] The Institution should seek specific advice from its technical advisors regarding those Services that can be postponed.

[186] Such as road projects, or multi-stage IT projects.

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The choice of which alternative to apply will depend on the overall time period between the final Scheduled Service Commencement Date and full Service Commencement. The longer the period, the more reluctant the Private Party is likely to be to accept the delayed payment involved in the first alternative above.

20.2 Existing Services

20.2.1 The acceptance procedure raises other issues if the Private Party takes over existing infrastructure and Services.[187]

20.2.2 The first issue is when and to what extent the Private Party takes responsibility for availability of existing services. There are three options available to the Institution:

20.2.2.1 the responsibility for all sites (including existing sites and new sites) is assumed by the Private Party from the Signature Date. This is the simplest option as it minimises complexities regarding the respective responsibilities of the Institution and the Private Party and is, therefore, the recommended approach. However, where there are concerns about the condition of existing buildings constructed and maintained by third parties, this approach may expose the Private Party to risks that it cannot manage and it may therefore only be willing to accept those risks at a greater cost to the Institution, which may compromise value for money;

20.2.2.2 a phased handover of the existing site so that the Private Party takes responsibility for these sites only when it is given vacant possession of such sites to commence its required Works. This leaves the Institution responsible for certain sites between the Signature Date and the date on which the Works are scheduled to commence on site. Also, the issue of who is responsible for the costs of bringing the sites up to full output

[187] For example, the take-over of existing accommodation and related facilities management services.

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specification level has to be agreed. Unless clearly stipulated in the RFP, it is unlikely that the Private Party will easily accept the risk of these costs, especially without having first undertaken an extensive due diligence (see Part D: (*Project Site*)); or

20.2.2.3 access (falling short of handover) to the existing site for the purpose of carrying out the Works followed by a handover of all existing sites to a Private Party only once they have been brought up to the full output specification standard by the Private Party. This would cause additional complexities as the pre-Signature Date arrangements, involving in-house provision of services or a separate contractor, would continue simultaneously while the Private Party is carrying out the Works to bring the site up to the full output specification standard. This option is not preferred, as it creates potential for disputes over responsibilities. This can be mitigated by specifying in minute detail the interface between these respective roles.[188]

20.2.3 In some cases, the existing condition of buildings may be such that there is a risk of pre-existing non-compliance with health and safety legislation. The PPP Agreement will require the Private Party to conduct the Project Deliverables in accordance with applicable law, thereby exposing the Private Party to legal risk for pre-existing conditions. Even if the funders of the Private Party permit the Private Party to assume all risk for pre-existing conditions (which is improbable), they will be reluctant to permit the Private Party to assume this risk during the period before the Service Commencement if the Private Party does not have exclusive possession of the site. In such circumstances, the Institution may consider entering into an ordinary service

[188] Certain projects have provided for "enabling works" to be undertaken prior to the Signature Date in an attempt to fast-track the Works once they actually begin. These works can be undertaken by the preferred bidder or a third party. While Institutions have tended to favour "enabling works" as they can fast-track a project, "enabling works" have similar risks to those detailed in Section 20.2.2.3 and are therefore not advisable. To the extent that this is unavoidable given the specific project, it is preferable that these "enabling works" be undertaken by the preferred bidder as opposed to a third party.

In other projects, the Services adjoin services provided by a third party or the Institution. Again it is imperative that the interface be clearly detailed so as to minimise any disputes.

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provision arrangement until the commencement of the Service Period, since in a traditional "input"-based contract there is no substantial risk transfer. This means that the Institution still retains responsibility for the buildings until Service Commencement.

20.2.4 In some User Pay PPPs, User Charges may be billed for some Services[189] before all the Services are fully available.[190] In relation to the takeover of existing Services, this principle will not be strictly applied. Here, the Institution can take one of two approaches in relation to User Charges during the transitional period (that is, the period between initial delivery and full Service Commencement). The selection of either approach will depend upon which provides the best value for money:

20.2.4.1 the User Charges to be made before Service Commencement are benchmarked to the current expenditure of the Institution (pre-Signature Date) subject to a performance regime, which entails that Availability Deductions will be made if the building is unavailable and Performance Deductions in the event of poor performance. Payment for those parts of the Services that are available will not diminish the significance of full Service Commencement as the Private Party will be incentivised by the performance regime to achieve full Service Commencement; or

20.2.4.2 no User Charges are payable during the transitional period. This maximises the incentive on the Private Party to bring the Facilities up to the full Service Commencement level as quickly as possible, but may not satisfy the cash flow needs of the Private Party.

[190] See Part F (*Services*).

[190] See Part F (*Services*).

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21 SECURITY AGAINST LATE SERVICE COMMENCEMENT

21.1 Introduction

21.1.1 The Institution may want to ensure that it and the end users are protected against late Service Commencement but should do so in a way that provides value for money (taking into account the actual losses the Institution may suffer for late Service Commencement and the necessity and cost of implementing contingency plans, such as providing or continuing to provide alternative health or educational facilities).

21.1.2 In considering the issue of late Service Commencement, the Institution should acknowledge that the Private Party is likely to be as concerned as the Institution to meet the Scheduled Service Commencement Date, given the cost of alternative funding if the User Charges do not commence and the risk of default under its Financing Agreements as the User Charges will not be available to meet scheduled debt service. A delay in Service Commencement will reduce the Private Party's revenue-earning period. The Private Party is likely to put measures in place to mitigate the effects of late Service Commencement such as insurance or standby debt and/or standby equity facilities. The Lenders, however, usually require standby debt and/or standby equity facilities as part of their security package and, while this provides comfort to the Institution, the Institution should not require it. The adequacy of these mitigation measures should be considered by the Institution in its due diligence (see Part B:4 (*Project Documents and Project Deliverables: Project Documents*)).

21.1.3 It may be argued that if the Institution will not suffer significant losses resulting from late Service Commencement, then the protections allowed by security will not be needed. This argument may not apply in all cases. Non-availability of key Project Deliverables or performance shortfalls may not occasion any *direct* losses to the Institution (except where, for instance, the PPP Agreement provides for a revenue share or the Institution is deprived of taxes levied on the

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user charges); however, the loss in that case would be for the end users who will be deprived of the Services or may have to procure substitute services at additional cost.

The issue of security against late Service Commencement must be considered on a project-by-project basis, regard being had to the particular phases of the relevant project, the specific risks in each such phase, the Institution's exposure during each such phase and any existing protections already in place that would mitigate these risks, such as guarantees from the Subcontractors to the Private Party, non-payment of the User Charges until the Services commence and any restrictions on the transfer of the Equity for a defined period. The Institution must analyse these during its feasibility study, bearing in mind the specific risk/s that it seeks to mitigate, the type of security available as well as the value for money and affordability considerations. It is possible to obtain extensive security as protection against late Service Commencement but the Private Party will price the costs of providing such security into its bid. Where it is essential to obtain some form of security given the particular project or particular phase of a project, this may be justified. The different types of security available to the Institution in order to ensure timeous Service Commencement include construction bonds and liquidated damages. At the feasibility stage of each project, the Institution must assess its security requirements in relation to that project. In the RFP the Institution should clearly stipulate the type as well as the amount of any security that it will require from the Private Party and request that each bidder cost for such security separately from its total bid price as this will aid in the evaluation process. See Part F:32.5 (Services: Maintenance in General) for security regarding the condition of the Project Assets during the Service Period and Part N: 57 (Termination: Handback) for security regarding the condition of the Project Assets immediately prior to the Expiry Date.

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21.1.4 The Institution may also want to protect itself against prolonged uncertainties arising from late Service Commencement by having a Long Stop Date after which it may terminate the PPP Agreement.

21.1.5 Once the Parties have agreed on the type of security to be provided, the PPP Agreement must clearly stipulate how the proceeds of such security will be applied. Given that it will usually be called upon in cases where the Private Party has defaulted, the proceeds should first be applied towards rectification of the defect. Thereafter, depending on what has been agreed with the Lenders, the remaining proceeds could be applied towards debt service. The exact nature of this waterfall will depend on the specific needs of the particular project.

21.2 Liquidated Damages

21.2.1 Liquidated damages for late Service Commencement are an ascertained payment representing a genuine pre-estimate of the actual losses or damages the Institution will suffer if the Private Party fails to achieve Service Commencement on time. Such actual losses or damages may be readily quantifiable in some but not all Projects. For example, the loss to the Institution from a delay in payment of agreed 'concession fee' or tax revenues (on the Services) will be direct, actual and quantifiable loss to the Institution. The cost of providing alternative Services during the delay in Service Commencement will also qualify. Conversely, delay in Service Commencement of a toll road project may not translate into direct, actual and quantifiable loss to the Institution.

21.2.2 If the Institution will suffer such losses, then liquidated damages will only be appropriate to the extent that they will result in value for money for the Institution taking into account all other protections which the Institution will have against late Service Commencement.

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21.2.3 To protect against late Service Commencement and consequent delay in cash flows from the Project from User Charges, the Lenders will usually require the Construction Subcontractor to cover the debt service for the period of the delay through liquidated damages payable to the Private Party and secured in favour of the Lenders. The Construction Subcontractor would, in turn, price the cost of such liquidated damages by increasing the Works price and by extending the Works period to include some contingency time. To the extent that the Institution also imposes liquidated damages on the Private Party these will also be passed on to the Construction Subcontractor which will result in an increase in the Works price. The Private Party will then be more than likely to pass these increases in costs on to the end users through inflated User Charges and/or by extensions to the Works period.

21.2.4 Liquidated damages may provide value for money in situations where the direct costs which the Institution will incur as a result of the delay, are so great as to justify the increased User Charges. This could be the case where there are "critical dates" for achieving Service Commencement and the costs of the Institution's contingency plans to cope with such critical dates are measurable.[191] Liquidated damages may also be justified where the Institution has contributed a valuable Institution Asset to the Project which could otherwise have been used by the Institution during the period prior to the Service Commencement for some other purpose, resulting in the Institution incurring an "opportunity cost".

21.2.5 If the imposition of liquidated damages will not impact severely on the value for money required for a PPP, the Institution should specify the level of liquidated damages (including any cap) in the RFP in order to enable the bidders to properly price for these damages. This will also assist the

[191] For example, in accommodation projects where the Institution may have to lease temporary premises to make up for the accommodation that is not available in time.

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Institution's evaluation team in exposing the "real" costs of the bid and improve competitiveness in the selection of the bids.

21.2.6 The Institution should ensure that the level of the liquidated damages reflects a genuine and reasonable pre-estimate of the losses which the Institution is likely to incur as a result of the delay in the Service Commencement. The amount of the liquidated damages should not be unrealistic, punitive or excessive as this will expose the Institution to the legal risk of non-enforcement of liquidated damages.[192]

21.2.7 Where the Institution will not suffer any direct financial losses in User Pay PPPs for late Service Commencement, liquidated damages will not be appropriate. This position is consistent with the legal position whereby proof of loss is required for liquidated damages. However, the Private Party must not be in a liability-free position, as delay in delivery of the Institutional function the Project is meant to achieve is itself an unacceptable result. The argument of the Private Party being delayed in earning revenues may not be sufficient. In such cases, the construction bonds (discussed below) may be the only option.

21.3 Construction Bonds

21.3.1 In the construction industry, construction bonds are generally given by construction contractors as a form of guarantee of completion (the amount guaranteed is usually a percentage[193] of the construction price). A construction bond will usually take the form of an on-demand bank guarantee which can be called by the recipient when, for example, the Scheduled Service Commencement Date is not met. Accordingly, the Private Party may well require a construction bond from the Construction Subcontractor who will pass through the costs and time effects of providing such a bond to the Private Party, who will in turn pass them on to the end users in the form of increased User

[192] This legal position arises under Section 74 of the Contract Act, 1872.

[193] Ten percent is generally accepted in Pakistan.

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Charges and/or Works period. Again, this may not result in the projected value for money, depending on the nature of the Project. The PPP Agreement should clearly stipulate how the funds will be applied, for example, first towards reinstatement and after that towards debt service.

21.3.2 If the Private Party defaults during the construction period and the PPP Agreement is terminated, then in many cases the Institution will be left with an asset. The Project Site, the planning Consents that will have been obtained prior to the Signature Date, and any construction work undertaken up to termination will all have some value to the Institution. The Institution may, however, be exposed if the Private Party defaults during the early stages of the construction period and the Institution cannot find another party to take over the Project and thus has to incur significant cost in reinstating the Project Site. This scenario is often unlikely in that the Private Party is more likely to invest further money into the Project in order to remedy a problem than it is to walk away and lose its Equity (together with the design and build costs invested up to date). Conceivably the situation could arise where the Private Party decides to abandon the Project if it is in default and faced with substantial rectification costs and if the Lenders decide not to enforce their security. The Institution will need to consider the probability of this risk occurring on a project-by-project basis.

21.3.3 The need for such bonds is greater when failure by the Private Party to complete the Works will result in substantial costs to the Institution. It is unlikely that the amount of such bonds will be sufficient to enable the Institution to complete the Works but it will, at the very least, provide the Institution with sufficient financial resources to procure a replacement contractor to complete the Works. Even if the Institution decides not to proceed with the Works, it may still incur costs in relation to restoring the Project Site to the condition it was in prior to the commencement of the construction. There is, on the other hand, very little

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need for a bond where the Private Party is handed an existing facility with minimal obligations during the pre-Service Commencement phase.

21.3.4 The Institution should carefully consider the need for construction bonds on a project-by-project basis, regard being had to affordability and value for money considerations. In the event that the Institution requires any such bond the objective should be (having regard to affordability and value for money considerations) to ensure that the bond only covers the period when the Institution is exposed and should automatically fall away when a predetermined and agreed trigger point is reached. This could occur when the Works have reached a certain pre-determined value or when the Completion Certificate is issued. The trigger point will, however, depend on the particular project and has to be determined on a project-by-project basis.

21.4 Sponsor Support

Sponsor support usually takes the form of undertakings from one or more of the sponsors of the Private Party in favour of the Lenders and/or the Private Party to support the Private Party's obligations to reach Service Commencement on time. This need not be a monetary guarantee and usually takes the form of technical support and/or general undertakings to ensure that the Private Party reaches Service Commencement. Although sponsor support is in favour of the Private Party and/or the Lenders, its existence does provide comfort to the Institution and the Institution should therefore consider the adequacy thereof in its due diligence.

21.5 Long Stop Date

21.5.1 Service Commencement should not be allowed to be delayed indefinitely due to Private Party Default. This is especially the case where the Institution is obliged under its statute to provide the public service or perform the Institutional function which is sought to be provided or performed under the PPP Agreement; the Institution remains responsible and accountable for the provision of the public service or performance of the Institutional function that

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is the subject of a PPP Agreement.

21.5.2 To deal with this, the Institution may impose a Long Stop Date after which the Institution may be entitled to terminate the PPP Agreement.

21.5.3 The Long Stop Date is a date fixed after and by reference to the Scheduled Service Commencement Date and is usually determined on the basis of the length of time the Private Party and/or its Lenders should reasonably be allowed to remedy the Private Party Default. In order to prevent hair-trigger defaults, the Long Stop Date is usually some time after the Scheduled Service Commencement Date (including the remedy period).

21.5.4 The Long Stop Date operates as a disincentive for delay. An alternative approach involves incentives for timeous or early commencement. This alternative approach relies on economic incentives for the Private Party to achieve early Service Commencement.

21.6 Incentives for Early Service Commencement

21.6.1

It may be proposed that 'incentive increments' to User Charges may be added for early Service Commencement. This should not be accepted; instead, early Service Commencement generates its own incentive in the ability of the Private Party to bill and collect User Charges early on in the Project and therefore for a longer duration than originally anticipated. In relation to User Pay PPPs, the prescribed position is that the Institution should not be obliged to accept early Service Commencement unless there is value for money. This must be assessed on a project-by-project basis. Early Service Commencement may provide value for money if there is an urgent demand for the Services (or if it would benefit the Institution financially). This might be the case if the Private Party makes savings in which the Institution shares.

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21.6.2 However, in a situation where the payment mechanism in a Hybrid PPP Agreement involves Unitary Payments payable by the Institution and is not exclusively based on User Charges , there may be budgetary constraints on the Institution accepting and paying (partially) for early Service Commencement.

21.6.3 If an Institution decides to accept early Service Commencement, the Private Party's revenue stream will commence earlier than originally planned. This however should not affect the Expiry Date, which should remain fixed. This should also not affect the performance regime and all other operational period obligations (e.g. insurance obligations) of the Private Party that should be brought forward to the date of early Service Commencement.

22 QUALITY ASSESSMENT

22.1 The Private Party should be under an obligation to implement a quality assessment and management system which meets the requirements of Good Industry Practice and any other applicable standards. This will depend on the nature of the Project.

22.2 The Institution should be entitled to review the Private Party's quality assessment and management system and, further, to rights of inspection to establish the adequacy and accuracy of that system. The PPP Agreement should provide for this and also for the Private Party to provide, and to cause the Subcontractors to provide, all reasonable assistance to the Institution in relation to that review and to respond to and implement results arising from such review.

22.3 No other rights or remedies (such as the right to terminate) should arise from any such review, as deficiencies in the quality assessment and management system will probably manifest themselves through poor performance in the delivery of the Services for which the payment mechanism should provide appropriate Penalty Deductions.[194]

[194] See Part F:23 (*Services*).

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PART F: SERVICES

23 SERVICES

23.1 The substance of a PPP is normally the procurement of Services.[195] The Institution should carefully consider its and the end users' needs in relation to the Services and the PPP Agreement should clearly detail the output specifications required to be met by the Private Party. The PPP Agreement must provide that the Services are to be available in accordance with the output specifications in the PPP Agreement and that Penalty Deductions from the Performance Security may be made for unavailability of the Services or for poor performance.

23.2 Delivery of the Services in a manner that exceeds the output specifications should not be rewarded by means of service credits. While service credits may have a certain appeal, they could result in the output specifications being set too low so as to result in regular service credits being awarded. In setting the output specifications, the Institution should seek to achieve an acceptable level of Services that are affordable and provide value for money. Also, as service credits often take the form of set-off against Penalty Deductions, the Private Party's responsibility[196] for poor performance in a critical area[197] could be reduced because it has performed exceptionally well in another area of the Project that is of little consequence.[198]

23.3 The requirements of each Project will determine the exact nature of the Services required. The availability of the Services is important because the

[195] The definition of "Services" is crucial. It must therefore be carefully defined in as much detail as possible. A separate annexure will be necessary.

[196] Penalty Deductions should however be weighted depending on the importance of the relevant aspect of the Services and the criticality of the loss of performance. Therefore, while service credits may result in reduced responsibility there should still be a monetary loss to the Private Party.

[197] For example, security in a prison project.

[198] For example, watering the plants in a prison project.

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end users are required to pay for the Services if they are available in terms of the PPP Agreement, even if they are not used (see Part H: (*Payment and Financial Matters*)).

23.4 In procuring the Services, Institutions must assess both their current and future requirements in terms of the delivery of the Institutional function underlying those Services. The demand or usage of the Services is a key risk assessment, which has to be determined throughout the Project Term. In drawing up the output specifications for the Services, Institutions should carefully consider the current as well as future requirements of the end users in order to minimise the need to change the output specifications. To the extent that this is unavoidable, such changes must be dealt with in terms of the Variations provisions, bearing in mind the impact on affordability.[199] However, Institutions should, if at all possible, ensure that adequate planning is done to ensure that the long-term demand for the Services can be met and all associated risks appropriately managed and mitigated.

24 DEFINITION OF "AVAILABILITY"

24.1 The concept of "availability" (or, at least, its converse) must be defined.[200] The definition should detail the specific conditions that must be met if the Services are to be considered available. The concept of availability usually relates to more critical failures and does not deal with less important performance related matters. The definition of availability must contain conditions which are objective, measurable and reasonable, and should not contain conditions which are unachievable or immaterial in the context of the Services as a whole, since the User Charges are due when these conditions are satisfied.

[199] See Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

[200] It may well be appropriate to detail the concept of availability in a Schedule to the PPP Agreement.

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24.2 Each PPP Agreement will require different conditions to be inserted into the definition which should, therefore, be as comprehensive as possible. Unavailability occurs if the relevant key objective conditions determining availability are not satisfied. Each Project will determine unavailability but, generally, unavailability will occur as a result of the non-availability of the Services.

24.3 The PPP Agreement should provide for unavailability to be measured following a simple process. Consequently, complex processes that require excessive monitoring costs should be avoided.

24.4 In several economic infrastructure categories, the User Charges are generally due when the Services are available, even if not utilised to the full allocated capacity (e.g. water supply schemes, electricity connections, waste collection projects, etc.). Penalty Deductions from the Performance Security are allowed in two instances. First, Availability Deductions when there is unavailability of the specified critical aspects of the Services and secondly, Performance Deductions for the less severe performance related failures.

24.5 The concept of "Scheduled Unavailability" relates to unavailability that is planned and agreed between the Parties. This is usually for reasons such as scheduled maintenance and should not result in deductions from the User Charges.

25 PAYMENT FOR AVAILABILITY

Payment for availability of the Services varies from project to project. Different types of projects require different payment mechanisms and allocation of payment depending on the availability of the agreed Services. (See Part H: (*Payment and Financial Matters*)).

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26 COMMENCEMENT OF AVAILABILITY

The PPP Agreement must specify the date/s for the provision of the Services and the consequences, if any, where the Services are available either before or after the Scheduled Service Commencement Date. The Private Party will not be authorised to bill for User Charges before the Scheduled Service Commencement Date unless specifically agreed to in the PPP Agreement. To provide for the management of the delivery of the Services, the PPP Agreement should provide for adequate notice to be given to the Institution and the Independent Certifier in circumstances where the Private Party anticipates that there will be early availability of the Services, and also where the Private Party knows that there will be a delay.[201] The Private Party should not be entitled to issue an Availability Certificate until the Independent Certifier has issued the Completion Certificate.

27 COMMENCEMENT OF UNAVAILABILITY

Unavailability of the Services will commence when an unavailability failure occurs. When the failure has been rectified and, if necessary, certified (by, for example, a safety officer), the Services will automatically revert to being available again.

28 RECTIFICATION

28.1 Unless adequate tolerances are already incorporated in the required availability and performance levels set for the Services, the PPP Agreement should provide for a rectification period within which the Private Party is given the opportunity to rectify the problem without triggering the start of a period of unavailability or the accrual of Penalty Deductions. The period allowed for rectification will depend on the nature of the Project, the nature of the problem, Good Industry Practice, as well as the importance of the availability

[201] This is in addition to any notices required in respect of acceptance and Service Commencement. See Part E: (*Duration and Service Commencement*).

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or performance of the specific Services to the Institution. Important factors in assessing rectification are responsiveness, rapid assessment, situation management and rectification in accordance with the availability and performance specifications in the output specifications. A failure to meet certain availability criteria may not be capable of rectification, in which case the provisions dealing with termination (see Part N: (*Termination*)) will apply. If the nature of the Project permits, the Private Party should be allowed to provide adequate alternatives, so as to ensure continuity of the Services.

28.2 If the problem is corrected in the rectification period, then no Penalty Deductions should be made. If the problem is not corrected in the rectification period, then the Services should be deemed to have been unavailable even in the rectification period and Penalty Deductions should be made.

29 SERVICE UNAVAILABLE BUT USED

29.1 The PPP Agreement must specify what happens if the end users commence use of the Services despite the existence of defects, which would otherwise render parts of the Services unavailable (e.g. in case of a partially completed toll road project where the end users commence plying on the road). Each Project needs to be considered according to its own Services requirements, but the fundamental principle to be applied is that the Private Party should not receive full payment where it does not provide the Services to the required availability standard.

29.2 Availability is a critical factor in all PPPs. Therefore the dispute resolution procedure should contain a mechanism to ensure a quick resolution of any disagreement in this regard. This is usually by means of an Independent Expert. (See Part S: 81.2 (*Miscellaneous: Fast-track Dispute Resolution*)).

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30 RESTORATION OF AVAILABILITY

When the failure that resulted in the poor performance or unavailability has been rectified, the Services will once again become available. There should be an agreed procedure by which the Private Party notifies the Institution that the Services are once again "available" or that the poor performance has been rectified. While the Institution may want the right to inspect the operations or review documents, it should not be drawn into intricate procedures to confirm availability. Like initial "availability", the Private Party must certify this and, if any part of the Services are not available, the Availability Deductions should be triggered. Likewise, if the performance has not been rectified, the Performance Deductions should be triggered. While the Institution has certain statutory functions relating to the monitoring of the Services, their availability and performance are the responsibility of the Private Party. The Private Party must ensure that mechanisms have been set up which will enable it to self-monitor availability as well as performance.

31 PLANNED MAINTENANCE

31.1 Ongoing maintenance is required to ensure that the Private Party keeps the Facilities in a condition that meets the required output specifications throughout the Project Term. (See Section 32 (*Maintenance in General*)). As maintenance is the responsibility of the Private Party, the Private Party should determine the nature, frequency and duration of any maintenance that it requires in order to meet the output specifications as well as fulfil its obligations under the PPP Agreement. The Private Party should prepare a programme for the planned maintenance and provide the Institution with a copy of such programme for its information. The Private Party should be under the obligation to ensure that any and all maintenance that it undertakes does not interfere with the operations of the Institution. To the extent that such interference is unavoidable, the Parties should agree on the programme for

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such maintenance so as to minimise any such interference. The Private Party should be entitled to amend its maintenance programme. This should, however, not derogate from its obligations to supply the Services under the PPP Agreement.

31.2 There should be no Availability Deductions during periods when preventive maintenance takes place as planned in the PPP Agreement. The Private Party will have to balance whether maintenance occurring at times other than those agreed will result in the improvement or worsening of its financial position (for example, by postponing or accelerating maintenance).

32 MAINTENANCE IN GENERAL

32.1 Introduction

32.1.1 The Private Party should base its costings on a forecast capital replacement programme of plant, machinery, equipment, fixtures, fittings and/or furniture designed to maintain the Facilities in order to meet the required output specifications. The Private Party will also consider the means of funding this expenditure throughout the Project Term. The risk associated with assessing what will need replacing, when and how much this will cost, is one that the Private Party should take and therefore the Institution should not attempt to be prescriptive in this respect.

32.1.2 The Institution will find it easier to achieve this risk transfer if its required output specifications are clearly expressed. The bidders should be allowed to develop their own proposals, which may, for example, incorporate alternative programmes of maintenance where assets with a longer life are used or used differently. An Institution should refrain from imposing its own system of asset replacement on the bidders because this may adversely affect risk transfer.

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32.1.3 A planned preventive maintenance programme is recommended so that both Parties know when parts of the Services are permitted to be "unavailable" without any Availability Deductions. In addition, provision should be made for how emergency maintenance, if any, will be handled so as to ensure minimum interruption of the Services.

32.2 Expiry of the PPP Agreement

As the Expiry Date approaches, the Institution's interest in the maintenance of any Project Asset will become most acute where such Project Asset is to be transferred to the Institution on expiry. At the Signature Date, the Parties must agree on the requirements relating to handover of such Project Assets at the Expiry Date. (See Section 32.4 (*Monitoring*) and Part N: 57 (*Termination: Handback*)).

32.3 Alternative Use

How, when and to what extent maintenance should be undertaken is the responsibility of the Private Party. If the PPP Agreement requires that any Project Assets be handed over to the Institution on termination or expiry, then the Institution should consider obtaining some security from the Private Party in order to ensure that the Project Assets comply with the requisite standards at handover. (See Section 32.5 (*Security for Maintenance Obligations*) and Part N: 57 (*Termination: Handback*)).

32.4 Monitoring

Particularly where the Institution will take over Project Assets at the end of the Project Term, the performance by the Private Party of its maintenance obligations as stipulated in the PPP Agreement will need to be monitored throughout the Project Term (other than through the performance monitoring

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system, see Section 33.3 (*Monitoring Methodology*) and thus a mechanism needs to be agreed whereby this can be done in as non-intrusive a manner as possible. This is, however, merely a monitoring function on the part of the Institution. Although the Private Party should be informed of any non-compliance with its maintenance obligations as stipulated in the PPP Agreement found by the Institution, the Private Party should not be obliged to follow any particular course of action as a result of such findings. Only if the monitoring indicates unavailability or poor performance, should Penalty Deductions be made. The Private Party's failure (following notification from the Institution) to fully perform its maintenance obligations will ultimately be reflected in reduced compensation on termination.

32.5 Security for Maintenance Obligations[202]

32.5.1 The User Charges are generally calculated to include amounts to cover the Private Party's anticipated future expenditure on maintenance. The Private Party will therefore usually build up a maintenance reserve over some years in anticipation of significant capital expenditure in future periods including in the final years of the Project Term, if the Institution is to take over any Project Assets at the expiry of the PPP Agreement.[203]

32.5.2 The Institution should generally not require security in respect of the Private Party's maintenance obligations during the Service Period as poor performance can and should be penalised by the accrual of Performance Deductions. An exception is permitted for bonds that are used to secure

[202] See also, Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) for a discussion of alternative forms of security.

[203] Throughout the debt service period, the Lenders will be concerned with the level of the Private Party's maintenance reserve(s) given that the non-performance by the Private Party of its maintenance obligations will be reflected in the amount of the compensation payable to the Private Party on termination (that is, the compensation will be reduced to reflect the condition of the poorly maintained Project Assets at that time).

Once the Debt has been repaid (which will ordinarily occur well before the end of the Project Term), the Lenders will have no interest in the condition of the Project Assets on handover to the Institution.

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the Private Party's *final* maintenance obligations in relation to the Project Assets where these are to be transferred to the Institution on termination or expiry.

32.5.3 The need for such security in the PPP Agreement has to be measured on a project-by-project basis. Maintenance should, however, generally be at the Private Party's risk and, therefore, the Institution should not attempt to prescribe the *quantum* or availability of any maintenance reserve account or other provisions (for example, a sinking fund) kept by the Private Party to meet its maintenance obligations. However, details of the balance of such account should be provided to the Institution on an annual basis.

32.5.4 The Institution should generally not require rights over any maintenance reserve account established by the Private Party and should instead ensure that the maintenance requirements are adequately protected through the payment mechanism and termination provisions.

32.5.5 As any compensation payable to the Private Party by the Institution on a termination is usually reduced by all cash held by the Private Party, including amounts in any reserve accounts, the Institution should not need any additional rights over any maintenance reserve accounts and thus the Lenders may be permitted to hold security over such reserve accounts.

32.6 Security for Final Maintenance Obligations

32.6.1 Where the Project Assets are needed for the provision of essential services after the end of the Project Term, it is advisable for the Institution to request some form of security in relation to the condition of

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the Project Assets on handover. In this respect, final maintenance bonds have proved to be useful.

32.6.2 Final maintenance bonds are a form of security that has been used in projects where residual value risk has not been transferred to the Private Party. These are typically on-demand bank guarantees that are often costly to procure. They are often issued during the last 18 to 24 months of the Project Term and remain valid for a few months after the Expiry Date.

32.6.3 Another option may be to require the Private Party to establish a maintenance reserve account[204], funded by setting aside in reserve a predetermined amount from the User Charges in the final months[205] of the Project Term and to deposit those into a maintenance reserve account. Reserve accounts can, however, prove to be rather costly as withholding such payments creates a lost opportunity cost which is often greater than the cost of a bond.

32.6.4 A further option may be a compromise between the two approaches where the Private Party is required to provide a final maintenance bond and, only if it fails to do so, may the mechanism in the PPP Agreement for reserve building through setting aside a pre-determined amount form the User Charges should become operative. . This will, however, depend on the specific project and will need to be assessed by the Institution on a project-by-project basis, having regard to, among other considerations, value for money. The Institution must clearly assess this risk during feasibility and stipulate its requirements in the RFP. The bidders must be asked to price for this security separately.

[204] Private Parties may prefer this as these accounts will accrue interest.

[205] This period will vary from project to project and may be anything from 12 to 36 months.

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33 PERFORMANCE MONITORING

33.1 Introduction

33.1.1 Although the User Charges are due and payable on availability, performance of the Services to the required output specifications is important as Performance Deductions will accrue for poor performance.

33.1.2 The PPP Agreement should therefore clearly set out:

33.1.2.1 the level of performance entailed by the required output specification;

33.1.2.2 the means by which the Institution is able to monitor the Private Party's performance against such required level; and

33.1.2.3 the consequences for the Private Party of a failure to meet the required level.

33.2 Setting the Performance Level

33.2.1 In order to encourage innovation and optimise risk transfer, the PPP Agreement should specify the required performance level through output specifications and not required inputs (that is, the manner of the Services delivery).[206] Suitable performance levels will need to be worked out carefully by the Institution and the bidders during the competitive stages of the procurement. The negotiated performance levels will form a key element of the risk transfer mechanism.

[206] In IT projects, where technology is constantly changing, the performance level may be set so as to include the concept of "continuous improvement". This will involve a review of the service levels over the Project Term. Here, the Institution should retain the right, subject to agreed controls, to set the performance levels as well as the relationship between the performance levels and the deductions.

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The setting of performance levels is a function of the strategic objectives of the Institution (that may even be set forth in quantitative terms in the applicable legislation) and the specific sector to which the Project relates, as well as the Project itself. For instance, in a water supply project, the performance levels can relate to progressive reduction in unaccounted water ratios, a rise in the bill collection rates, maximum waiting time for connection and progressive reduction in contamination levels. In a Project for waste management, the performance levels could include minimum trips per collection cycle: a reduction in the number of trips may reduce the 'preformance level' – even if the total waste tonnage collected per collection cycle remains the same – as the collection bins may be filled beyond capacity resulting in litter and filth around the collection bins.

33.2.2 In setting the performance levels, the Institution should focus primarily on what it requires, taking into account affordability and value for money and not, for example, on what it is accustomed to. Affordable performance levels should be set by the Institution based on Good Industry Practice.

33.2.3 If the Institution is already providing the same type of service as all or part of the Services, this may provide a comparator against which the Institution may compare the quality and price of the Private Party's bid.

33.2.4 An alternative method is to set the performance levels by reference to the average performance levels of a comparator group made up of other providers of the same or similar services. For example, in prisons the comparator group would include a number of similar establishments and as such the levels of performance by the service providers in those

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establishments are ascertained and an appropriate comparator is thereby obtained.

33.2.5 This is however not recommended because if there were to be a deterioration in the quality of services elsewhere, then the Private Party would benefit in that it would (even if it were able to perform fully and is unaffected by the reason for a wider deterioration) be expected to perform the Services at a lower level.

33.2.6 As with availability (see Section 24 (*Definition of "Availability"*)) and performance, the funders will be concerned that the performance level required is reasonable and objectively measurable. They will seek to establish that the User Charges will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that allows the Debt to be serviced and the Equity return to be paid. In considering what a reasonable level is, the Institution should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the Services) to set the required standard in the PPP Agreement at this level.

33.2.7 In some cases, the Institution may recognise that an optimum 100% standard is not always achievable or essential. As such, the Institution may retain the optimum 100% level but allow a specified leeway before the Private Party suffers Penalty Deductions for unavailability or poor performance.

33.3 Monitoring Methodology

33.3.1 There must be a methodology in the PPP Agreement that enables monitoring of the Private Party's performance against the required output

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specifications in the PPP Agreement so that the performance measurement system can operate effectively.

33.3.2 The monitoring requirements should be set out in the RFP and a full methodology must be included in the bid. The methodology will normally include a substantial element of self-monitoring by the Private Party, subject to periodic Institution review. Additional Institution monitoring may also take place depending on the nature of the Project, for example, clinical staff in a hospital identifying and reporting performance failures. The periodic reports[207] to be provided by the Private Party will be key to the management of the PPP Agreement and to the payment mechanisms, and should be specifically tailored to meet these monitoring requirements. A distinction must be made between the monitoring mechanism formulated and implemented by the Private Party and any actual monitoring undertaken by the Institution as and when it deems necessary in accordance with the PPP Agreement. The Private Party should have the primary responsibility for the former and the PPP Agreement should clearly provide how it will conduct this self-monitoring which will constitute the basis for the calculation of Penalty Deductions.

33.3.3 Monitoring involves the collection and evaluation of data that should be objective, relevant and quantifiable. There should be a clear connection between the data collected, unavailability, poor performance and the Penalty Deductions.

[207] See Part H:38 (*Payment and Financial Matters: Reporting Requirements*).

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33.4 Commencement of Performance Monitoring

33.4.1 The PPP Agreement must specify the date by which the performance levels are to be achieved. In some projects, such as IT projects, it is recognised that problems are inevitable in the settling-in period, and thus the Private Party may be afforded a degree of flexibility in achieving the agreed performance levels. In other projects such as roads and prisons (where the safety element is crucial), it is essential that the Private Party ensures there are no settling-in problems and that the full performance level that the Parties agreed will be delivered from day one, is indeed delivered from day one, even if the road or prison is opened in phases. In the case of such phased Service Commencement, the amount of the User Charges may be ramped up proportionately to reflect the phased Service Commencement.[208]

33.4.2 One approach, which gives flexibility in the settling-in period, is to allow the Private Party to accrue a lower number of Penalty Deductions during that period than would accrue during the remainder of the PPP Agreement. Some projects (for example, where the Services involve a relocation from existing Facilities into new Facilities) have made successful use of agreed performance levels where Private Parties are allowed a three to six months settling-in period. During this time monitoring takes place, but any Penalty Deductions imposed on the Private Party for poor performance are set at a lower level than is the case once operations are fully established (but, in such cases, this does not affect the Institution's rights to terminate for Private Party Default).

[208] See Part E:20.1.5 (*Duration and Service Commencement: Acceptance and Service Commencement*).

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33.5 Replacement of Subcontractors

33.5.1 Altering the performance regime is not appropriate in the case of replacement of Subcontractors, as it is the Private Party's responsibility to manage its Subcontractors and thus the Private Party should bear the risk of their poor performance. The Institution should not be disadvantaged by any change in Subcontractors, so the performance regime should not be interrupted by any such change.

33.5.2 Nevertheless, the Institution should allow the Private Party to replace its Subcontractors (subject to the Institution's right to pre-approve the replacement Subcontractors)[209], in order to improve performance and avoid termination. To enable it to do so, the Private Party will normally set a stricter termination threshold (or trigger termination at an earlier point in time) in its Subcontracts than that which applies in the PPP Agreement.

33.5.3 However, if the Penalty Deductions have already accrued to a level where a minor default could trigger termination, the Private Party may find it impossible to attract a replacement. In projects where there is only one Subcontractor (or even two Subcontractors) and where the pool of available replacement subcontractors is small, the Institution should permit the suspension of the accrual of further Penalty Deductions for the purposes of termination only for a limited period of time[210] after the replacement Subcontractor has been appointed (a "settling-in" period). In order to avoid this relief from termination being abused, the PPP Agreement should prohibit the Private Party from invoking this relief more than twice in the Project Term.

[209] See Part S: 78.2 (*Miscellaneous: Subcontracting*).

[210] This period should be long enough to attract a replacement subcontractor and enable it to rectify the failure but still be short enough to incentivise the Private Party to remedy the defect quickly.

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33.6 Who Does the Monitoring?

33.6.1 A key issue to be resolved is who will do the monitoring: the Institution, the Private Party, the Parties acting jointly or an independent third party?

33.6.2 Monitoring should occur at three levels:

33.6.2.1 a systematic self-monitoring by the Private Party through a quality management system measuring performance;

33.6.2.2 a review of the Private Party's quality management system by the Institution (or an independent third party) including a combination of certain scheduled and random spot checks (with an ability to increase monitoring on repeated failure or poor performance); and

33.6.2.3 the ability for users to report failures (for example, clinical staff and service personnel).[211]

33.6.3 Whatever the system that is agreed on, this must be incorporated into the PPP Agreement so that the process by which Penalty Deductions are made is clear and unambiguous. There should be no debate as to whether an event is a failure and subject to a deduction.

33.6.4 Monitoring is ultimately the responsibility of the Private Party. This will usually be dealt with as part of the quality management system run by the Private Party. Mechanisms must be in place to ensure that the Private Party collects and provides data accurately. Failure by the Private Party to adequately self-monitor should in itself result in Penalty Deductions. The method of self-monitoring which the Private Party will use must be agreed on with the Institution in order to ensure that such a

[211] If the staff are employed by the Private Party this may create a conflict of interest and may not be appropriate.

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self-monitoring system accurately captures any unavailability or lack of performance in delivery of the Services. It is essential that the Institution satisfies itself that the self-monitoring system proposed by the Private Party is adequate, since the data collected using this system will ultimately be used to calculate the Penalty Deductions. Where a Private Party provides the information, such information should be in a format stipulated by the Institution[212] who should obtain a right of review (for itself or through an independent third party) to verify the information.

33.6.5 The obligation of the Private Party to self-monitor its performance of the Services should not be confused with the Institution's obligation to monitor in terms of its statutory obligations[213]. Mechanisms and procedures for such performance monitoring must be established by the Institution even before the PPP Agreement has been executed in order to ensure that the PPP Agreement is properly enforced. Accordingly, the Institution must ensure that sufficient resources and staff with the right level of experience are available to manage and monitor the PPP Agreement. Some PPP Agreements have provided for joint training and development of Institution and Private Party staff to encourage partnership.

33.7 Who Pays for the Monitoring?

33.7.1 As a substantial portion of the monitoring is self-monitoring, the Private Party should bear the costs of monitoring. In respect of any reviews of the monitoring systems by the Institution, the Institution should bear the costs. However, in the event that the review reveals that the monitoring

[212] The Institution must ensure that this is consistent with the requirements in this regard to be laid down in the PPP Manual for audit of PPP Projects.

[213] Keeping in view that the Regulatory Instruments are expected to stipulate that approval of a PPP Project by the Approving Authority will require, amongst others, that the Institution should demonstrate its capacity to monitor the implementation and monitoring of the PPP Project.

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systems are defective and the output specifications are not being met, the Private Party should bear the costs of that review.

33.7.2 The monitoring arrangements should be proportional to the consequences of Services failure. This will ensure that where it is possible to have a less onerous system it will be in both Parties' interests to do so. Equally, where the consequences of failure are severe, for example, hygiene in an operating theatre, water contamination levels in a water supply project or emission levels in a waste management project, then a rigorous monitoring system should be specified.

33.8 Addressing Qualitative Factors

Objective performance criteria should always be used as far as practicable, but other methods of measuring performance may be appropriate in some specific Projects. For example, in some Projects there may be qualitative aspects of performance to which it may be difficult to apply Penalty Deductions objectively, but which are nevertheless important to the users of the Services, such as the helpfulness of staff or the quality of catering. Three possible approaches for measuring these aspects of performance are the use of end-user satisfaction surveys, the use of "mystery shoppers" and sampling:

33.8.1 *End-user satisfaction surveys*[214] – it is difficult to base financial compensation on end-user satisfaction surveys because they are based on individuals' perceptions rather than on objective measurable facts and so the results of such surveys may vary. However, over time they are a useful way of monitoring performance. The Private Party could be obliged in terms of the PPP Agreement to improve end-user satisfaction and, where a survey reveals that a particular aspect of the Services falls

[214] The questions should be carefully drafted in order to achieve a meaningful response.

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below the agreed level, it would have to implement a rectification plan which should be agreed with the Institution. The advantage of such a system is that if end-users clearly understand the quality of Services contracted for, the feedback obtained can be very useful.

33.8.2 *Mystery shoppers* – a similar approach could be adopted with "mystery shopper" surveys (that is, the use of qualified individuals to test aspects of the Services). This removes the perception aspect of testing since the relevant individuals will apply the same objective standards to all aspects of the Services tested.

33.8.3 *Sampling* – where monitoring is to be done on a sampled basis, the methodology for sampling, including sample size and frequency, should be agreed prior to the Signature Date.

Certain Projects do not lend themselves particularly to any of these approaches. Regardless of which method is used, the quality of Services must be considered in detail by both Parties and included in the PPP Agreement.

33.9 Monitoring of Subcontractors

33.9.1 An Institution may feel the need to use the PPP Agreement to allow it to intervene at Subcontractor level to protect its interests when a Subcontractor is performing poorly (for example, the Institution may want the right to direct or require the replacement of the Subcontractor). This approach is not recommended as it should be for the Private Party to manage its Subcontractors and thus intervention by the Institution will affect the degree of risk transfer achieved. Similarly the Institution should not seek to obtain any direct undertakings or guarantees from the Subcontractors. The Institution should instead rely on the payment mechanism, termination and its other rights in the PPP Agreement as

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against the Private Party to address poor performance by the Subcontractors.

33.9.2 Penalty Deductions under the payment mechanism and, ultimately, the risk of the Institution terminating the PPP Agreement, should be a sufficient incentive for the Private Party to manage its Subcontractors' performance. The Private Party will typically ensure it has the right, under the Project Documents, to replace its Subcontractors before the Institution's right to terminate arises under the PPP Agreement. Concerns regarding Subcontractors' performance may be further addressed in the PPP Agreement by requiring a temporary increase of monitoring at the Private Party's expense in specified circumstances as well as requiring the Private Party to provide an acceptable plan outlining how any defects in the Services will be remedied. Both of these measures impose costs on the Private Party and are only acceptable if there has been a persistent and verifiable period of unavailability or poor performance.

33.10 Reporting the Results of Performance Monitoring

33.10.1 The PPP Agreement will need to specify the way in which information regarding performance is reported. Wherever possible, monitoring should allow co-ordination of report production in a way that avoids duplication of effort and all Project participants (including the Lenders) should consider carefully what is needed. The key issues which have to be considered are:

33.10.1.1 what reports are required? By whom? How frequently? Are different reports required by different people in the organisation, for example, contract manager, chief executive officer and so forth?

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33.10.1.2 is there to be a standard monitoring form or an IT compatible format to present results?

33.10.1.3 how soon after a monitoring period is the report to be received?

33.10.1.4 how often are meetings required between the Institution and the Private Party? Who is required to attend from either Party?

33.10.2 Penalty Deductions imposed in respect of a specific failure should be the Institution's exclusive remedy in respect of that failure (except to the extent that any termination rights depend on levels of accrued Penalty Deductions or the PPP Agreement provides for other specific remedies, such as indemnities). The levying of Penalty Deductions will, however, not relieve the Private Party from its obligations to remedy the defect or from any of its other obligations under the PPP Agreement.

33.11 Consequences of Poor Performance

33.11.1 The PPP Agreement must set out clearly the consequences of any failure by the Private Party to perform to the minimum standards of the required output specifications.

33.11.2 One approach is for the Private Party to incur a specified number of Penalty Deductions for each failure, with the level of deductions incurred varying according to the seriousness of the failure. The value of the Penalty Deductions should be set based on commercial considerations as opposed to the cost of providing the Services. The PPP Agreement would in this case include a schedule setting out in detail the level of Penalty Deductions imposed for each failure to meet a required output specification. There should be a clear link between the seriousness of the failure, the value of Penalty Deductions accrued and the potential

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financial impact on the Private Party. For example, a failure to clean the exterior of the windows in a hospital should not accrue as high Penalty Deductions as a failure to maintain the operating theatre in the specified condition. Similarly, different failures in respect of the same part of the Services may also incur different Penalty Deductions depending upon the context in which they arise. For example, a failure to deliver food in a suitable condition is a more serious failure than a failure to serve food wearing a waiter's uniform.

33.11.3 Depending on the type of payment mechanism used, a failure may or may not result in immediate Penalty Deductions[215] It is possible for Penalty Deductions to only start once performance deteriorates below a particular level or alternately for them to accrue on the first failure.

33.11.4 In some projects it will be more appropriate to have a ratchet mechanism to deal with persistent failure to render a particular aspect of the Services. A simple ratchet mechanism could involve increasing the level of Penalty Deductions awarded for a particular failure in the Services that recurs too often within a specified period. For example, if Penalty Deductions equal to x are made for a failure to achieve a particular output specification then Penalty Deductions equal to (x+3) may be made for each failure over and above a specified maximum number of failures within a pre-defined period.

33.11.5 The ratchet mechanism can be particularly useful where the financial cost of Penalty Deductions which accrue in respect of each such failure is insufficient to provide an appropriate incentive on the Private Party to rectify the failures. A key advantage of the ratchet mechanism is that poor performance which continues for a significant period will be more

[215] This will depend on the type of payment mechanism used.

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difficult for other Project participants (for example, Subcontractors and the funders) to ignore, thereby encouraging early action by the Private Party.

33.11.6 If the ratchet mechanism is overly complicated it will be difficult to manage while the inclusion of onerous measures in the pricing mechanism can affect value for money. It is important to tailor the ratchet mechanism to a particular Project in a way that produces the best value for money. In establishing a suitable system, the Institution will have to be aware of the effect a particular system has on the proposal offered by a bidder. For example, a bid proposal that is capital intensive up-front with reduced consequential life cycle costs will have one optimum approach, whereas one with lower up-front capital costs but with higher life cycle costs will have a different optimum approach (that is, they are most effective at different points in the respective financing plans). It is crucial for the Institution to understand what level of commercial hardship experienced by the Private Party (through the ratchet mechanism) will best achieve the result it desires. An overly rigid approach during negotiations will reduce the scope for innovation by the bidders and so reduce the potential for best value for money to be achieved.

33.11.7 The payment mechanism should as far as possible cover every aspect of the Services. Where all-encompassing performance standards are not feasible or do not sufficiently address persistent failures, the Institution should consider what recourse it should have against the Private Party for sub-standard performance that is not covered under the required performance standards (see Part N: (*Termination*)).

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33.12 Security for Service Obligations

33.12.1 The Unitary Payment Standardisation in general recommends that security for the obligations of the Private Party to perform the Services in the form of a performance bond during the Service Period is not necessary (excluding the last few years if there is provision for a final maintenance bond). Having a bond in place for a period as lengthy as the Service Period is considered costly and may impact negatively on value for money considerations. The approach under the Unitary Payment Standardisation works because there the Institution is able to withhold Penalty Deductions from the Unitary Payment for unavailability and poor performance.

33.12.2 The position is quite different in User Pay PPPs, where the payment is collected by the Private Party directly from the end users. While some end users may dispute their obligation to pay for unavailable or poorly delivered Services, a uniform approach is neither possible nor visible for effective monitoring purposes. Further, direct performance control by the end users will be unacceptable to Private Parties as the end users' perception of the degree of performance will be largely subjective, and not controlled by the contractually agreed performance levels.

33.12.3 In User Pay PPPs, therefore, security for performance must be placed in the hands of the Institution, who is best placed to monitor and enforce the performance regime on a holistic basis. While this will result in the cost of the Performance Security being built in the User Charges, this cost is justified given the alternatives being less acceptable. The following options for Performance Security may be considered:

(a) Performance Reserve Account: the Private Party may be required to set aside a pre-determined amount from the User Charges until the 'Performance Security Reserve Account' is funded to a pre-agreed

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level. The Private Party will recommence replenishing this account by setting aside the pre-determined from the User Charges when the balance in the account falls below a specified threshold (say, 20%).

(b) Letter of Credit: the Private Party establishes a letter of credit in a pre-determined amount. The letter of credit is replenished to its original amount when the amount thereof available for draws falls below a specified threshold (say, 20%).

33.12.4 The Performance Reserve Account has the apparent attraction that no up-front costs are incurred by the Private Party. However, the Institution carries the risk that the reserve amount may take some time to build, and there may be an interim period when there are insufficient funds available to make the draws. Also, it is debatable if this really results in a reduction of the overall cost to the Private Party, since its cash flows will be reduced by a corresponding amount and the Lenders will require this deficit to be funded by the sponsors, who will pass on this cost to the Private Party which will in turn pass this on in the form of a cushion built in the User Charges.

33.12.5 Choosing the appropriate form of Performance Security will be a function of the specific Project and this decision may be made on a case to case basis after careful analysis and on advice of the financial advisers to the Institution. However, considering the key role the Penalty Deductions play in the performance control of the Private Party, it will be preferable to have sufficient Performance Security available from Service Commencement for the entire Project Term. Accordingly, unless value for money considerations dictate to the contrary in a specific Project, the preference should be for the Institution to demand a letter of credit. To address value for money considerations, the letter of credit could be structured such that the amount secured thereunder may be reduced if the Penalty Deductions remain below a

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specified level for a pre-agreed period, with the amount being increased to its original amount only if the Penalty Deductions in a succeeding period increase beyond the threshold level. To illustrate, the Institution may agree that if the amount secured under the letter of credit is drawn by less than half for a continuous period of one year, the amount secured may be reduced by half for the succeeding year. If the Penalty Deductions at any time in the next year reach eighty percent (80%) of the secured amount (half the original amount), then the secured amount should be increased to the full original amount. This way the Private Party will be incentivised further to maintain its performance levels.

33.12.6 The discussion in this User Pay PPP Standardisation is premised on the Performance Security consisting of a letter of credit.

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PART G: PROJECT ASSETS

34 EQUIPMENT AND MATERIALS

34.1 The procurement of the equipment and materials included in the Project Assets and their availability for achieving the required output specifications is a type of "availability risk", which must be borne by the Private Party during the Project Term. Therefore, the Institution should generally not be prescriptive about the types of equipment and materials to be used in the Project or the methods (often described as "method statements") to be used to satisfy the output specifications in the PPP Agreement.

34.2 The PPP Agreement must state that all equipment and materials that are to be used in the provision of the Services should be of a satisfactory quality and meet all relevant statutory requirements and the appropriate standards, including those specified by the specific industry associations, [216] or equivalent specifications and/or codes of practice. In managing the issue of "quality" and to avoid any confusion during the Project Term, quality issues must be decided prior to the Signature Date and incorporated into the PPP Agreement.

Standard Clause

Equipment Standards

The Private Party shall ensure that the goods, equipment, consumables and materials used by it or any Subcontractor in connection with the provision of any of the Services (each as a distinct and separate obligation) are:

(a) maintained in a safe, serviceable and clean condition in accordance with Good Industry Practice;

(b) of the type specified in the service level specifications and/or the method statements (where appropriate);

[216] Including those specified from time to time by the Pakistan Standards and Quality Control Authority.

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(c) in compliance with any relevant rules, regulations, codes of practice and/or applicable [Pakistani or international standards][217]; and

shall, as soon as practical after receiving a request from the Institution, supply to the Institution evidence to demonstrate its compliance with this Clause.

34.3 The PPP Agreement must also make provision for the treatment or storage of any necessary hazardous materials, substances and equipment. It should oblige the Private Party to ensure that all hazardous materials, substances and equipment used or stored on the Project Site are kept in accordance with all applicable law and Good Industry Practice, properly and securely labelled and stored, under appropriate supervision and used only by appropriately trained and competent staff. Furthermore, the Private Party should use all practical and reasonable means to prevent or counteract any unlawful emissions, unlawful discharges or unlawful generation, accumulation or migration of any hazardous substances at or from the Project Site and prevent any circumstances arising which are likely to result in any environmental claims.[218]

34.4 Alternatively, the PPP Agreement should prohibit the installation, keeping and use of any hazardous materials, substances and equipment not necessary for the provision of the Project Deliverables if these may cause damage to the Facilities or bodily injury, endanger health and safety, or may have the effect of transferring the risk associated with them to the Institution.

34.5 In certain Projects, consumables may be acquired by the Institution for use in the Project Assets, for example a cartridge (being the consumable) in a printer (being the Project Asset). The PPP Agreement should set a minimum standard for these consumables and, provided that the consumables acquired by the

[217] The Institution must seek advice from its technical advisors on this matter. Adoption of international standards, where these result in higher overall project costs, must be weighed against the impact it will have on value for money and affordability of the Project.

[218] See Part D:14.2 (*Project Site: Environmental Risks*).

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Institution comply with this standard, the Private Party will continue to remain liable for the proper functioning of the Project Asset concerned.

35 REPLACEMENT AND UPGRADING

35.1 The replacement of obsolescent (used here in the sense of being obsolete to the required output specifications) or "out-of-date" Project Assets is part of the availability or operational risk that should be assumed by the Private Party.

35.2 The Lenders will often require that the Private Party adhere to a replacement programme. In its due diligence, the Institution should ascertain whether this is indeed the case, as the existence of such a programme will provide some comfort to the Institution regarding the Private Party's ability to fulfil its obligations in terms of the PPP Agreement.

35.3 As a general rule, therefore, the Institution should not seek to impose an obligation on the Private Party to replace the Project Assets in accordance with a specific replacement programme or be prescriptive regarding the timing or manner of replacement. The Private Party will, however, usually have a replacement programme, detailing in respect of each category of Project Assets, for the Project Term, projected replacement and/or upgrading tasks, dates and costs.

35.4 In exceptional circumstances the Institution may require that the Private Party adhere to a replacement programme. These would usually be circumstances where the Lenders have not insisted on a replacement programme or in certain types of projects, such as IT projects involving health or medical equipment where there are rapidly changing standards and a high risk of obsolescence.

35.5 Even in these exceptional circumstances it is important for the Institution to remember that it will have no recourse in the event of non-compliance with the

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replacement programme. The Institution will only be entitled to levy Penalty Deductions if the output specifications have not been met. The only benefit of a replacement programme is that non-compliance provides the Institution with an early warning.

Standard Clause

Project Assets: General Obligations

The Private Party shall at its own cost and risk, provide, deliver, install, commission, manage, maintain, repair, renew and replace (as the case may be) the Project Assets (or part thereof) at such times and in such manner:

(a) as to enable it to meet the [output specifications] for the Project set forth in Schedule [x];

(b) as to ensure that the Private Party is, at all times, able to provide Services;[219]

(c) without limiting Clause (a) above, as would be required having regard to Good Industry Practice; and

(d) as required by law.

35.6 The Institution should consider whether or not any replaced Project Assets could be utilised by the Institution at other facilities (not forming part of the Project) under its control. For example, replaced Project Assets at a tertiary level hospital could be utilised at other hospitals where they may be needed. If so, then the Institution should ensure that the PPP Agreement provides for appropriate acquisition terms and a methodology for valuing the replaced Project Assets.

[219] It may be appropriate, depending on the particular project, to provide that the Services be rendered using "state of the art" equipment and systems. This requirement does, however, have cost implications and may result in the project being too expensive to ensure value for money for the Institution. If this requirement is adopted, then the term "state of the art" must be defined. The Institution should seek the advice of its technical advisors in this regard.

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36 SECURITY OVER PROJECT ASSETS

36.1 Project Assets Not Already Belonging to the Institution

36.1.1 The Institution should carefully consider which, if any, of the Project Assets it will require at the end of the Project Term in order to continue provision of the services. These are likely to be those Project Assets that are essential or critical for the ongoing provision of the services. During the procurement phase of a project, the Institution must notify the bidders of the Project Assets that it will require at the end of the Project Term by identifying such Project Assets, whether individually or by category or class, so that this may be priced into the bids that are submitted.

36.1.2 Any Project Assets that the Institution requires at the end of the Project Term should not be available to the Lenders as part of their security package but may form part of the Institution's security package. This will, however, be reflected in the cost of the Debt. The Institution must, therefore, on a project-by-project basis, assess the situation taking into account value for money and affordability considerations. Any Project Assets not identified by the Institution as contemplated in Section 36.1.1 may form part of the Lenders' security package.[220]

36.1.3 If the Institution has informed the Private Party that it wishes to take over any Project Assets at the end of the Project Term, it may require security over such Project Assets in order to protect its interests in them against the Private Party's other creditors. Specific legal advice should be sought by Institutions wishing to take any security interests over any such Project Assets regarding the nature of the security that would be appropriate. In the case of tangible movable Project Assets, specific

[220] See footnote 268.

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advice should be sought regarding the appropriateness and practicality of registering a hypothecation charge that extends to replacement assets.

36.2 Institution Assets

36.2.1 Pakistan law does not provide for a uniform definition or treatment for public property. Article 173 of the Constitution provides that the grant, ownership, sale, disposition or mortgage of any property vested in the Federal or Provincial Government will be carried out in the exercise of their respective 'executive authority', unless provided otherwise in any law. This Article does not limit the definition of property and therefore the general definition under the Constitution applies that covers all kinds of movable, immovable and intangible property. Therefore, unless the property is subject to any specific law, the powers of the Federal and Provincial Governments to confer security interests on their property are unlimited. This Constitutional position is applicable for properties directly owned by or vested in the respective Governments, and not to any statutory corporation or business enterprise that is controlled or owned by the respective Governments. In the latter case, the statutory corporation or business enterprise is not the Federal or the Provincial Government for the purposes of the Constitution but a separate legal entity.

The power of a statutory[221] body to create a security interest over its property will depend in large measure on the statute creating that body. The precise legal position is debatable as to whether an express statutory power to create a security interest is essential or whether the *absence* of any statutory prohibition suffices. If (i) a statutory body is empowered in the statute to own and dispose its property, to contract, and to sue and be

[221] E.g. National Highway Authority, a Local Government organization, a municipal development authority, etc.

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sued in its name, (ii*)* there is no express prohibition in that statute against creation of security interest, and (iii) the property vesting in that body was not given on any terms restricting creation of security[222], the assumption would be valid that such body would in law be entitled to create a security interest over its property.

The extent to which an Institution can confer security interest in the Institution's Assets requires careful analysis and legal due diligence when the feasibility study is conducted. Non-compliance by any Institution with the statutory requirements under its parent statute and with other statutes that apply in the context of the particular transaction will render the security invalid.

36.2.2 As regards any *non-physical property* of such Institutions and *all property* of any government business enterprises[223] that may be made available (as Institution Assets) to any Private Party under PPP Agreements, the recommended approach in this Standardisation is that Institutions should not grant any security whatever over any such Institution Assets *to secure their payment obligations* under PPP Agreements.

36.2.3 The exemptions to attachment and sale in execution of a decree under the civil procedural law[224] do not include public property as an exempted category; the implication being that attachment and sale of properties of Institutions in execution of decrees is permitted under law.

[222] For example, where property was acquired under the Land Acquisition Act and then transferred to the statutory body. See the discussion in this behalf under Section 11.3.

[223] Statutory or otherwise.

[224] Section 60, Civil Procedure Code, 1908.

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PART H: PAYMENT AND FINANCIAL MATTERS

37 PAYMENTS

37.1 Introduction

The PPP Agreements require the receipt by the Private Party of a benefit for performing the Services or pursuant to its use of any Institution Assets. In User Charges PPPs, these benefits will come from the user charges billed and collected by the Private Party in exchange for the Services rendered to the end-users, for example, tolls for a toll road, water supply charges for a water supply project, and waste collection and disposal charges for a waste management project.

In Hybrid PPPs, a part of these benefits will come from periodic payments made by the Institution in the form of "Unitary Payments". To the extent Unitary Payments are involved in a User Charges PPPs, reference may be made to the Standardisation for PPP Agreements based on Unitary Payments; the principles set forth therein will apply to the Unitary Payment component of the benefits to the Private Party. These benefits may come from (i) the Institution's annual budgetary allocations, (ii) the Institution's own revenues, or (iii) partial or complete payment through a separate subsidy mechanism (alone or in combination, referred to in this Standardisation as a "Unitary Payment").

37.1.1 Annual Budgetary Allocations – for Unitary Payments in a Hybrid PPP

37.1.1.1 The Constitution lays down the process for annual budgeting by the Federal Government and the Provincial Governments. In respect of the Federal Government, the Constitutional requirements translate into an "Annual Budget Statement" being laid by the Federal Government for

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each year before the National Assembly that lays down the '…*estimated receipt and expenditure of the Federal Government…*"[225] for that year, and that '…*distinguishes expenditure on revenue account from other expenditure*". Except where capital contribution of the kind permitted under this Standardisation is made by the Institution, in most cases the Unitary Payment would constitute current expenditure.

37.1.1.2 In terms of Article 82 of the Constitution, the statements in the Annual Budget Statement reflecting the current expenditure for the relevant year for Unitary Payments would constitute "…*demands for grants*…" and would require the assent of the National Assembly for such allocation on an annual basis.

37.1.1.3 In relation to any PPP Agreement to which a departmental Institution is a party, the accounting officer of that Institution is responsible for, among other things:

(a) reporting to the relevant Treasury at the beginning of each financial year, all expenditure commitments under that PPP Agreement anticipated in that financial year;

(b) ensuring that such expenditure commitments are incurred in accordance with the allocation for that Institution in the Finance Act for that financial year; and

(c) preventing irregular and unauthorised expenditure by that Institution.[226] If the expenditure commitments of a departmental Institution under a PPP Agreement are not covered (whether at all or sufficiently) in the relevant

[225] Article 80 of the Constitution.

[226] See the Rules of Business for the Federal and Provincial Governments.

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allocation and such expenditure is nevertheless incurred, it will be classified either as "unauthorised expenditure" or "irregular expenditure".

37.1.1.4 In the case of a public entity (other than a government business enterprise), its accounting authority is responsible for, among other things:

(a) ensuring that its expenditure commitments under a PPP Agreement in any financial year are included in its budget for that year when that budget is submitted to its executive authority for its approval;

(b) ensuring that such expenditure is incurred in accordance with that budget; and

(c) preventing irregular expenditure.

37.1.1.5 In the case of a government business enterprise that is partially or wholly 'self-funding' and therefore not reliant (partly or exclusively) on budgetary allocations under the Annual Budget Statements :

(a) its expenditure commitments in any financial year arising under a PPP Agreement must be included in its annual budget for that financial year submitted to the accounting officer designated by the executive authority responsible for that government business enterprise; and

(b) its accounting authority is responsible for preventing irregular expenditure.

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37.1.1.6 Institutions should therefore ensure that their expenditure commitments for Unitary Payments required to be made under any PPP Agreements to which they are party are adequately budgeted for in accordance with the requirements of the Constitution and/or the parent statute.

37.1.2 User Charges

37.1.2.1 A User Charges PPP will primarily entail the provision of Services to customers or end users in exchange for tolls, tariffs or other similar charges.

37.1.2.2 The setting, levying and collection of any user charges generated under a PPP Agreement must meet the requirements for tariff setting and collection in the parent statute, as well as any sector-specific legislation applicable to a PPP (for example, in the case of a PPP for generation of electric power, the provisions of the Regulation for Generation, Transmission and Distribution of Electric Power Act, 1997).

37.1.2.3 Where not regulated by a sector specific legislation, the Institution requires legal advice on case to case basis to ascertain the legal source for setting the tariff for user charges and any public sector approvals required in this regard.

37.1.2.4 In contrast to collection, and as a general rule, tariff setting may not be delegated to a Private Party. Simply stated, this means that

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an Institution may not agree in its PPP Agreement to delegate any discretion it has to set tariffs to a Private Party.[227]

37.1.2.5 *Tariff Setting; Tariff Design*

(a) In setting the user charges for a User Charges PPP Project, a distinction must be made between (a) the initial structure of the tariff, and (b) revisions to the initial tariff set at the Signature Date.

(b) The tariff may be regulated by a sector-specific statute for tariff setting and modification by the sector-specific regulator, for example, in the case of the power, oil and gas, and telecommunication sectors, the tariffs are regulated by regulatory bodies set up under specific statutes. In such cases, tariff regulation is "regulation by statute", and the PPP Agreement must be drawn up with the statutory provisions and the precedent tariffs in view.

(c) Where not regulated by any sector-specific legislation or principles established by a sector-specific regulator, tariff setting and modification will require addressing in detail in the PPP Agreement. In that case, it will be a matter of "regulation by contract". Regulation by contract binds the parties to the PPP Agreement to the setting, modification and review of tariff in the manner and subject to the provisions of the PPP Agreement, and poses significant challenges in determining the underlying design and objectives.

[227] This is because tariff setting is a legislative function, which government is constitutionally prevented from "fettering" by agreement. There are limited exceptions to this fettering rule. An Institution considering such an agreement for any PPP in which user charges are a source of revenue generation for the Private Party, should obtain specific legal advice in this regard.

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(d) Initial tariff design is primarily a function of economic analysis and the socio-economic strategic objectives of the Institution. One of the key assumptions of this Standardisation is that the choice of delivery of Services by performing the underlying Institutional function through PPP modality is a strategic choice of the Institution that will steer the 'tariff design' for the User Charges, which will serve the strategic objectives of the Institution.

(e) The intended tariff design should be determined by the Institution at the feasibility stage that will serve its strategic objectives, and should not be left to the bidders. Not only it is beyond the scope of this User Pay Standardisation to recommend any preferred tariff designs, it is also unrealistic to do so as the design will vary with the sector and the given project. However, set below are a few key matters that may be addressed in the initial tariff design. The RFP ought to specify the strategic and socio-economic objectives and priorities of the Institution in proposing a tariff design in the RFP, and the bidders may be given limited freedom to propose variants to the design that serve, and not derogate from, the stated objectives; for example, differentiated tariffs for different end user categories (lower tariffs for life-line consumers in the power sector); time of service (peak and off-peak rates for water supply schemes), coverage requirements (mandatory coverage to low income or rural areas for a water supply scheme), and the affordability of the User Charges for the end users.

(f) Any tariff-design must not lose sight of the fundamental principle that the price of the Services should reflect the costs incurred in providing that Service. These costs should, as a minimum, include the direct costs of the Private Party in providing the Services. A

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cost-covering tariff design is key to a successful bidding process and a viable PPP Project. Where affordability constraints prevent a full cost-covering tariff design, the Institution should look for any transparent subsidy options available, for instance, under the viability gap funding scheme of the Federal Government.

(g) The following are amongst the range of options for design and setting of c*ost-covering tariffs*:

(i) Flat Rates: End-users are charged a flat rate for services regardless of the quantity consumed. The tariff is determined with an analysis of usage patterns, such that costs are flattened out across a total estimated quantity consumed. However, this methodology is economically inefficient, in that consumers are indifferent to 'time of use' and may consume high quantities in peak-demand periods. As it costs significantly more to supply a small quantity of a good or service in peak-times, the 'marginal cost' of such supply far exceeds the average cost of supply and results in over-investment, and consequently a higher per-unit flat rate. Flat rates do not send the right price signals to the end users to shift their consumption patterns in a manner that can reduce the overall investment to meet the target demand.

(ii) Two-part tariffs: Such tariffs comprise of a fixed-charge and a per-unit consumed charge. The fixed-charge is generally set with reference to the fixed capital cost of constructing the Project (debt servicing and return on equity) and the per-unit charge is set with reference to the operating costs (that will generally vary with the volume of Services delivered). Two-part tariffs are preferred by private investors in capital intensive sectors

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such as electricity, water supply and telecommunication sectors. However, the fixed-charge needs to be maintained at an affordable level so that low volume end users are not compelled to disconnect.

(iii) Declining Block Tariffs: These are advocated on the basis that large consumers are cheaper to serve than smaller ones. The tariffs decrease when an end user consumes above a minimum quantity: tariff slabs provide incentives for higher consumption. However, these may be seen as penalising small volume users who fall within the first block where the price may be set higher than the marginal cost of service to cater for the 'average connection cost' to all the end-users.

(iv) Increasing Block Tariffs: Here the tariff rises with increasing consumption: tariff slabs provide disincentives for higher consumption. Such tariffs may be desirable where the Services are in scant supply, for example, in water supply schemes in water deficit areas. However, the higher priced blocks are generally priced above the marginal cost of service, and in effect subsidise the lower block end-users.

(h) Hidden Costs

(i) The charges by Institutions to their end users while providing the Service underlying the Institutional functions themselves generally do not account for 'hidden costs' or 'hidden subsidies'. Such user charges are generally set considerably lower than full cost-recovery tariffs.

(ii) Affordability analysis in User Pay PPPs takes into account affordability for the end users. In Unitary Payment PPPs,

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the affordability analysis takes into account the affordability of the Project for the Institution, taking into account its current and future budgetary allocation.

(iii) Estimates of the expected tariff for User Pay PPP Projects at the RFP stage will remain flawed unless the 'hidden subsidies' or 'hidden costs' are made transparent and accounted for. These are costs that are incurred by a Private Party in providing the same infrastructure and related service that are not accounted for by an Institution because these are either not required to or are parked under overall budgetary grants for the Institution. For instance, typically, only salaries and consumables are included in the current expenditure for waste collection services by local governments. However, in calculating the cost base for the private sector, these hidden subsidies or costs include debt servicing, duties and taxes, insurance, social benefits, administrative overheads and utilities charges.

(iv) Recurrent costs too ought to be transparently factored in estimating the likely tariff at the RFP stage: these can include: *direct operational expenditures*, such as expenditure on wages, fuel, and maintenance; provisions (accrued expenses) for liabilities such as employee pension obligations and insurance payments; *regular recurrent cash outlays*, such as debt repayment and service charges (capital and interest) or a *provision* (depreciation) for recovering the value of the capital assets progressively used up in delivering the Services.

(v) It is important to note in this context that costs that the Private Party will demand to include as recurrent costs (roughly all

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the items mentioned above) may not be considered as recurrent costs by the Institution. For example, all capital expenditures of local government may be funded from another source (distinct from the source of recurrent expenditure), and so interest and loan repayments may not be included as recurrent costs for local government. Insurance may not be included. It is even possible that pension contributions will not be regarded as a recurrent cost, because they are paid by another department. For these reasons the number of items included in recurrent costs by the private sector is often much more than for the public sector, and so the private sector may appear to have higher running costs.

(vi) Initial tariff setting should therefore take into account all the capital and recurrent costs for a Project on a ring-fenced basis, and the Financial Model should reflect all such items of costs.

37.1.2.6 *Tariff Adjustments*

(a) As discussed above, cost-covering tariffs are key to a sustainable PPP Project. A 10 or 20 year PPP Agreement will necessitate pre-agreed parameters for adjustments to the end-user charges to ensure the returns from the Project during the Service Period. In the absence of such an arrangement, bidders will inflate their prices substantially to maintain their returns and will seek "front-end loaded" tariffs where their expected returns are extracted early-on rather than over the entire Service Period.

(b) A distinction must be made, however, between 'extraneous' and 'internal' factors impacting the 'cost-of-service delivery' during the Service Period (also termed as 'exogenous costs' and

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'endogenous costs'). Extraneous factors relate to circumstances over which the Private Party has no control, and which are of general application; inflation being one example. Internal factors are those over which the Private Party has control; e.g., the efficiency of production. Upward tariff adjustments are not to be offered for the latter category of factors.

(c) The rules applicable to tariff adjustment rules may be placed in three categories:

(i) indexation rules and revisions thereto;

(ii) rules for periodic adjustment to the basic tariff; and

(iii) rules for price adjustment for unforeseen circumstances.

The first category is discussed further in section 37.2.4. The third category is discussed partly in section 37.2.7 below and partly in Part K: *Unforeseeable Discriminatory Government Conduct and Variations*.

(d) The key questions to be addressed in the RFP and in negotiating the PPP Agreement in relation to the rules for periodic adjustment to the basic tariff may be summarised below:

(i) how frequently should tariffs change;

(ii) procedure for revising the tariff;

(iii) categories of extraneous costs for which the Private Party should be protected; and

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(iv) how can incentives for productive efficiency be preserved.

(e) The tariff adjustments should not provide for increase of tariffs to compensate the Private Party in respect of risks that are for the Private Party in User Charges PPPs. Reference may be made to the discussion in section ••• (Assumptions) in this regard. These risks include market or demand risk, collection risk, customer default risk and the billing risk. Thus, for instance, any reduction in demand for the Services should not justify an increase in the end-user charges, as this will result in the market risk being retransferred to the Institution. However, the PPP Agreement should generally enable the Private Party to make variations to its charging regime to stimulate the market for Services without, however, exceeding the User Charges stipulated in the PPP Agreement. For instance, offering rebates to end-users to use Services in off-peak hours may stimulate usage in off-peak hours, shift consumption patterns, and reduce the overall cost of the Private Party.

Recently concluded road concessions by the National Highway Authority provide for automatic escalation of toll rates by 10% every 3 years, and for NHA to compensate the concessionaire if the Government does not endorse the stated increase. In recently concluded concessions for port container terminal operations, the terminal operating company has the right to increase the container handling charges by 15% every 2 years after obtaining approval of the port authority.

Such concession agreements do not indicate any linkage between the input costs or operating efficiencies of the concessionaires with the pre-agreed tariff escalations, nor provide for any objective criteria or procedure for such increases. In the absence of any mechanism for sharing of the increased returns with the Institutions where the demand projections are

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exceeded, such flat enhancements have the potential of over-compensating the concessionaires.

(f) The guiding principle should always be that the Private Party should remain incentivised to maintain efficiency in its operations and Service delivery, while being enabled to earn a reasonable rate of return. In achieving this objective, some and not all factors affecting the costs of the Private Party may be taken into account for tariff adjustments. Risk for the factors excluded from consideration rests with the Private Party; these may include plant operating efficiency, working capital financing, remuneration rates of skilled staff and spare parts availability. Risk for the factors included is with the Institution or allocated to a third party, e.g. to exchange rate hedge providers. Generalised price review clauses must be avoided.

(g) The prescribed approach in this User Charges Standardisation for PPP Agreements 'regulated by contract' for sectors where a sector-specific regulator does not exist is that no *reassessment* should be made of User Charges during the Service Period, except for (A) inflation indexation, and (B) indexation for variation to currency exchange rates where capital investment is denominated in foreign currency. By *reassessment* is meant an open ended review of the User Charges; it does not mean pre-identified periodic increase that is factored into the Financial Model for arriving at the User Charges for the entire Service Period.

(h) User Charges for PPP Agreements in sectors regulated by sector-specific statutory regulatory bodies will be governed by the tariff

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setting and readjustment regime prescribed by law or precedent set by the regulator. The Institution and the Private Party will have limited freedom in negotiating the tariff readjustment mechanisms. The foremost tariff adjustment (as also initial tariff setting) methods followed by regulatory bodies in Pakistan are:

(i) rate of return regulation; and

(ii) price cap regulation.

(i) Rate of return regulation

(i) Rate of return regulation limits the total revenue of the Private Party to enable recovery of "allowed costs" and a specified return on the invested capital. The first step is to calculate the revenue requirement, which entails determining the operating expenses, depreciation, taxes and the rate of return on the capital invested (also known as rate base). The initial tariff setting by this method entails a similar exercise with projected (and contractually committed) capital invested with required return thereon, operating expenses, taxes and depreciation. At adjustment, audited accounts are examined to determine the variation between the revenue requirement assumed in the Financial Model at the Signature Date, and the variation on the readjustment date. Extra returns are clawed back by reduction generally in the allowed return or the operating expenses for the next rate review period. The allowed rate of return is typically the weighted average cost of debt and equity.

(ii) The advantages of rate of return regulation include the security to Private Party of a fixed return that will be maintained

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'whole' during the Service Period. The disadvantages include reduced incentive to minimise costs (since costs will generally be allowed, unless these are found excessive on rate review), and the potential for over-investment to earn the assured return thereon.

(iii) The over-investment and inefficiency can be controlled by making the allowance for increased costs subject to a "prudency review", whereby costs that were not essential to maintain the agreed performance levels are disallowed. While this works in case of regulation by an independent sector specific regulator, such prudency review may not work well in case of regulation by contract. An Institution's objectivity in conducting prudency reviews may be influenced by several factors; its role as a contracting party with compensation obligations on termination, its keenness to perform the Institutional function underlying the Services at minimal level of User Charges, and the like. Regulation by contract requires upfront agreed rules for tariff adjustments, and leaving such matters to 'prudency reviews' at the discretion of the Institution may increase the risk perception and hence the premium the Private Party will demand on its investment.

(j) Price-cap regulation

(i) Instead of fixing the revenue requirement, this method focuses on fixing the total prices that can be charged for prolonged periods of time (say, five years) according to a pre-defined formula that takes into account future inflation and future efficiency gains expected from the Private Party; the inflation-adjusted price for future years is marked down by a percentage reflecting the

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expected efficiency gains in its operations by the Private Party. Inflation indexation (consumer price or manufacturer's price indices may be used) insulates the Private Party against extraneous cost increases, without eroding the incentives for efficiency. The Private Party has the incentive to increase its efficiency levels, for it keeps the difference between its total costs and total revenues.

(ii) The advantages of price-cap regulation include a stronger incentive for efficiency and greater comfort for the Private Party in that its returns will not be adjusted retroactively to maintain a fixed return over the Service Period. The disadvantages include a potentially higher cost of invested capital demanded by Private Party as it has to bear any unpredicted swings in the extraneous costs, and potential erosion of quality of service to cut costs (though this can be controlled by Penalty Deductions for shortfalls in service levels).

37.1.3 37.1.3 Benefits payable to the Institution

37.1.3.1 A PPP Agreement does not generally entail the receipt by an Institution of any fee, rental or other consideration in connection with a PPP; however, this may sometimes be feasible, particularly where a PPP involves the use of substantial revenue-generating Institution Assets, for example, toll road and eco-tourism projects. In Projects where charging a concession fee is an option, the

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Institution should examine the impact on affordability and value for money and should lean in favour of eliminating or reducing the concession fee where the impact will be to enhance the affordability of the User Charges.

37.1.3.2 However, if a PPP entails the lease of Institution Assets by an Institution (other than a public entity), then the prescribed approach is that the letting of state property by such an Institution pursuant to "operating leases" (as opposed to "finance leases")[228] shall be at "market-related" tariffs, unless the relevant Approving Authority specifically approves otherwise.

37.2 Payment Mechanism in General[229]

37.2.1 The payment mechanism is the essence of the PPP Agreement as it puts into financial effect the risk allocation between the Institution and the Private Party. It determines the User Charges chargeable by the Private Party and establishes the incentives for the Private Party to make the Services available in a manner that provides value for money. This Section 37 (*Payments*) must be considered in conjunction with Part F:23 (*Services*).

37.2.2 In general terms, the key features of a payment mechanism must be that:[230]

37.2.2.1 no User Charges should be payable until the Services are available (but see Part F: (*Services*) for when the Institution may accept incomplete Services);

[228] Operating lease does not transfer title at the end of lease period; finance lease generally does.

[229] See the assumptions at (B1) in the Preface.

[230] This section must be read with Sections 37.1.2.5 and 37.1.2.6.

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37.2.2.2 there should be a "single" User Charge for the Services in the sense that the payment should not comprise categories that are linked to the delivery of inputs (for example, labour and material costs), although such categories may be taken into account in relation to permitted inflationary increases (see Section 37.2.4);

37.2.2.3 the User Charges should only be paid to the extent that the Services are available; and

37.2.2.4 deductions for unavailability and poor performance from the Performance Security should be provided so that the Private Party is penalised financially, but deductions should reflect the severity of the failure, so that no Services[231] should lead to no payment, but a minor failure should only cause at most a minor deduction. These should be cumulative so that persistent failures may increase the level of deductions.[232]

37.2.3 The User Charges should always be linked to performance and/or availability of the Services.[233] It should not contain a fixed portion to which the Private Party is entitled irrespective of availability or its performance.[234]

37.2.4 In respect of the Services, the Institution should agree upon fixed User Charges over the lifetime of the Project, subject only to (i) certain inflationary increases, and (ii) indexation to currency exchange rates

[231] This may not mean a total absence of Services but is based on the availability criteria.

[232] See Part F:23 (*Services*).

[233] This is also applicable when the Private Party's revenue is determined by volume or usage as in the case of a toll road project where the revenue is the aggregate of the tolls that the Private Party is able to recover from road users. The volume risk should however always be borne by the Private Party unless value for money considerations dictate otherwise on a project-by-project basis. It may be possible to agree with the Private Party that any upside in excess of an agreed percentage be shared with the Institution in terms of a pre-determined formula.

[234] Such as a minimum portion required to enable the Private Party to meet its debt service obligations to the Lenders.

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where the capital investment is denominated in foreign currency, except where adequate exchange rate hedge options are available at prices that pass the tests of value for money and affordability. The inflation risk arising in relation to any project must be considered on a project-by-project basis. The following general principles apply:

37.2.4.1 this risk should be shared between the Institution and the Private Party;

37.2.4.2 if there is no inflation-indexation mechanism, the Private Party is likely to incorporate a contingency into its price, which is unlikely to give the Institution value for money; and

37.2.4.3 CPI is the recommended indexation mechanism for User Pay PPPs. However, whether CPI is the appropriate indexation mechanism for any PPP should be determined not only with reference to affordability but also value for money considerations. Institutions should consider alternative indexation mechanisms at the feasibility study phase of their PPPs (with reference to affordability and value for money considerations). Whichever index is selected, the choice of index must be specified in the RFP. The Parties may agree on a different index or basket of indices provided that the agreed index or basket of indices is reflected in the PPP Agreement as the applicable index/indices for the duration of the Project Term. In agreeing to an index or basket of indices, the Institution must ensure that the relevant index or basket of indices can be easily calculated, and that only indices that are published in Pakistan are used.

37.2.4.4 Inflation indexation should not apply to that part of the User Charges which reflects Debt repayment to the Lenders.

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37.2.5 Save for inflationary increases and currency exchange rate indexed increases where foreign capital investment is involved (in the latter case, only if any hedging mechanisms are not available or fail the value for money and affordability tests), there should be no other increases to the User Charges. The Private Party may seek to re-assess the User Charges or specified portions of it at pre-determined intervals during the Service Period in order to mitigate its risk that unforeseen circumstances during the Project Term may result in the User Charges being insufficient to cover its costs and yield anticipated profit margins. This should be resisted given its likely negative impact on value for money and affordability.

37.2.6 To the extent that the output specifications are amended resulting in an increase in the User Charges, this should be dealt with in terms of the Variation Clause.[235]

37.2.7 Depending on the specifics of the particular project, it may also be necessary to provide for "Pass Through Costs".

37.2.7.1 Pass Through Costs constitute costs that are incurred by the Private Party and which the Institution has agreed in advance for 'pass through' in the User Charges. To the extent that there are any such Pass Through Costs, these must clearly be stipulated in the PPP Agreement together with the procedure for adjustment to the User Charges in the event of such costs materialising. These costs will not include any mark-up by the Private Party or any administrative or handling charges. They are direct Pass Through Costs paid by the Private Party for which the PPP Agreement will provide for by addition to the User Charges. An example of such

[235] See Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

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Pass Through costs may be anticipated increase in customs duties on imported consumables for the Project for which local substitutes are not available.

37.3 37.3Penalty Deductions

37.3.1 A successful User Pay PPP design will seek to achieve optimal risk transfer of performance to the Private Party by direct linkage of Service failures with the ability of the Private Party to bill and collect for the Services. To the extent performance failure is automatically penalised by revenue deficit of the Private Party, the Institution is not required to seek securities of performance of the Private Party. However, this may not be achievable in some case where private sector entry is nascent and where the Institution can be held to account for failure to deliver the relevant Institutional function if the Private Party does not perform according to agreed performance levels. With private sector enjoying monopolistic conditions under a PPP Agreement for Services with little or no substitutes (e.g. a toll road or a water supply scheme), the case for the Institution to seek Performance Security from the Private Party is stronger. If the Private Party fails to perform, the prescribed approach in the User Pay PPPs is to obtain Performance Security and make Penalty Deductions thereon corresponding to the failure of Service. The exercise of Institution step-in rights may not be adequate or desirable, as step-in rights are exercisable in extreme circumstances and then too the Institution may not have the requisite means to run a large infrastructure project.

37.3.2 Penalty Deductions may be structured at a higher and a lower level. The higher level should be linked to the availability of the Services (see Part

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F: (*Services*)). For example, if certain prison cells or hospital rooms do not meet the relevant availability definition, then an Availability Deduction may be made . The test should be whether the Services are available and not whether they are used. The Private Party should be incentivised to rectify the default itself. Unavailability for a prolonged period may trigger termination.

37.3.3 The lower level of Penalty Deduction should be linked to levels of performance of the available Services (see Part F:33 (*Services: Performance Monitoring*)) and should involve poor performance being addressed by Performance Deductions which will vary according to the seriousness and regularity (if a ratchet mechanism is used) of the poor performance.

37.3.4 Once unavailability or performance deteriorates below a certain level (whether for a single failure or for persistent failure under a ratchet mechanism), or Penalty Deductions reach a certain level, then a range of other remedies can be invoked, from formal warnings that could lead to eventual termination for a Private Party Default.

37.3.5 As Penalty Deductions not only result in significant financial cost to the Private Party but could also result in termination once a pre-determined threshold has been reached, the Private Party often seeks to have the Penalty Deductions lapse or fall away for the purposes of termination after a certain period of time. While it is in both Parties' interests to ensure that the Project does not "limp along" indefinitely due to poor performance, the Institution should, on a project-by-project basis, assess whether it is feasible to have Penalty Deductions accumulate indefinitely for the purposes of termination or whether there is any merit in having

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them lapse or expire for termination purposes after a specified time period.

37.3.6 A combination of deductions for unavailability and under-performance may be used to address failure by the Private Party. Care should be taken, however, to avoid deductions of both types in respect of the same failure.

37.3.7 Penalty Deductions imposed in respect of a specific failure should be the Institution's exclusive remedy in respect of that failure except to the extent that termination rights depend on levels of accrued Penalty Deductions or the PPP Agreement provides for other specific remedies such as indemnities. Therefore, failures that are covered by Penalty Deductions should not entitle the Institution to termination rights for any other reason, for example, material breach.

37.4 The Payment Mechanism

37.4.1 In practice, a variety of payment mechanism structures have been used across sectors and project types (from availability-based mechanisms to service-based and usage-based mechanisms).

37.4.2 A possible model is one that focuses on broad accommodation areas, rather than individual places for the Services required. The User Charge is then based on a full provision of the overall Services so that the payment mechanism simply determines the Penalty Deductions for unavailability or poor performance. Availability is defined in terms of being usable and accessible (according to agreed specifications) and different Availability Deductions are made depending on which area is unavailable. For example, in a hospital project, each section of the hospital may be divided into units and given a weighting depending on its

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importance. For each failure to provide an available unit there is initially an Availability Deduction equal to the User Charge multiplied by the relevant weighting. The Availability Deduction can be based on an escalating tariff so that subsequent days of unavailability of the same space may lead to progressively higher deductions. A similar system can be used for poor performance and the resultant accrual of Performance Deductions.

37.4.3 A second possible model is one which follows the principles set out in Part F:33 (*Services: Performance Monitoring*). The User Charge is based on the number of available places or units so that only places or units that are available are paid for. The definition of available places or units incorporates ongoing core Services, and thus the deduction regime is only used to address levels of performance which impact on the availability of places and/or services that are within the definition of the core Services, with poor performance leading to Performance Deductions from the Performance Security.

37.4.4 The PPP Agreement should stipulate procedures for invoicing of User Charges including the manner of payment, currency of payment (which must be in Rupees), interest on late payment and whether the User Charges are inclusive or exclusive of GST (See Part S: 80 (*Miscellaneous: Taxation*)).

Standard Clause

Payment of User Charges

(a) *User Charges*[236]

[236] This Clause will have to be amended in the event of an adjustment to the User Charges to take into account reduced insurance premiums as a result of those risks that become Uninsurable and in respect of which Uninsurability relief is granted (see Part I:42 (*Insurance: Risks which Become Uninsurable*)).

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The Private Party shall not be entitled to bill and collect any User Charges until the Service Commencement Date.[237] *Subject to the provisions of this PPP Agreement, the Private Party shall be entitled to bill and collect the User Charges with respect to all Services each [period]*[238] *following the Service Commencement Date in accordance with the provisions of Schedule [x].*

(b) *Invoicing and Payment Arrangements*

The invoicing arrangements with respect to User Charges shall be as specified in Schedule [x].

(c) *Reporting Requirements*

(i) *On the [x]th Business Day of each [period] the Private Party shall deliver to the Institution in a form acceptable to the Institution:*

(1) *a report (the "**Period Revenue Report**") which shall set out:*

(aa) *the aggregate amount of User Charges invoiced and collected in respect of the previous [period];*

(bb) *the aggregate Penalty Deductions (if any) due in respect of the previous [period];*

(cc) *any GST due and payable in respect of any of the above amounts; and*

(dd) *the calculation of the applicable indexation factor*[239] *(if any).*

(ii) *The Period Revenue Report delivered pursuant to Clause (c) shall be accompanied by a performance period report for the relevant [period] (prepared by the Private Party) which details the performance for the relevant [period] and clearly shows the basis of calculation of each of the amounts referred to in the Period Revenue Report.*

[237] To the extent that any interim Services are provided prior to the Service Commencement Date, this Clause must be modified appropriately.

[238] The frequency of the Service Payments (for example, monthly, quarterly, etc.) will depend on the particular Project. This must clearly be stipulated in the PPP Agreement.

[239] See Section 37.2.5.

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(iii) The Institution shall within thirty (30) Days of receipt of the Period Revenue Report and the performance period report for the relevant [period] (prepared by the Private Party) notify to the Private Party any disagreement or requirement for further information by the Institution, in default whereof the Institution shall be deemed to have accepted the Period Revenue Report and the performance period report, provided, however that, such deemed acceptance shall not waive any rights or obligations of the Parties in relation to the matters set forth in the said reports to the extent of any material inaccuracies therein.

(d) <u>Disputes</u>

In case of dispute arising in relation to a Period Revenue Report and/or the performance period report for the relevant [period], the Parties shall use all reasonable endeavours to resolve the dispute in question within [x] Business Days of the dispute arising. If they fail so to resolve it, either Party may refer the dispute for resolution in accordance with the dispute resolution procedure in Clause [x] of this PPP Agreement. Following resolution of the dispute, the Private Party shall withdraw the original Period Revenue Report and the performance period report for the relevant [period] and issue a replacement Period Revenue Report and the performance period report for the relevant [period].

(e) <u>Penalty Deductions</u>

Penalty Deductions from the Performance Security shall be made as required by Schedule [x]. In the event of a dispute arising in relation to the level and quantum of Penalty Deductions, the Institution shall be entitled to levy Penalty Deductions in an amount which corresponds to the undisputed part of the period performance report for the relevant [period], provided, in the event the dispute is resolved in favour of the Institution, the Institution shall be entitled to levy additional Penalty Deductions consistent with the determination in the dispute, together with Default Interest thereon for the period for which the additional Penalty Deduction was deferred pending the resolution of the dispute.

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37.5 Set-Off

37.5.1 The Institution should ensure that the PPP Agreement contains an express right for the Institution to make Penalty Deductions . In respect of any other amounts owed to the Institution by the Private Party under the PPP Agreement during the Project Term there should, generally, be no right of set-off.

37.5.2 An exception is that the Institution should also be entitled to set-off any amounts that are required close to the expiry of the Project Term in order to reinstate the Project Assets to the state they ought to have been in, against amounts, if any, due to the Private Party or by draws on the Performance Security.

37.5.3 Another exception is in the case of termination, where the Institution should generally have the right to set-off amounts due to it by the Private Party against the termination compensation payment due to the Private Party. The issue of set-off on termination is however dealt with more extensively in Part N: 58 (*Termination: Compensation on Termination*).

37.6 Security for Payment of User Charges

The recommended approach is that no security (whether over Institution Assets or in the form of a guarantee or suretyship) should be given by any Institution or any other organ of state in respect of the payment obligations of the end users or any payment obligations (whether for Unitary Payments in Hybrid PPPs, indemnified claims, termination compensation or other amounts) of that Institution under a PPP Agreement.

The Institution may however be required in a PPP Agreement to use its statutory powers to recover the User Charges from delinquent end users where

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the statute confers coercive recovery powers on the Institution. It is rare for statutes to permit an Institution to delegate to a Private Party its powers of recovery of User Charges from delinquent end users. While the Private Party will generally be able to suspend Service or disconnect end users who default in their payment obligations, it will not be possible for the Private Party to exercise recovery powers for past due debts in the name of the Institution unless the statute expressly authorises such exercise. The Institution may agree in a PPP Agreement to exercise such recovery powers when requested by the Private Party. The expenses of recovery should be for the account of the Private Party.

38 REPORTING REQUIREMENTS

38.1 A robust PPP Agreement will[240] require that PPP Agreements be managed and that mechanisms and procedures be established for monitoring and regulating the implementation and performance of PPP Agreements, liaising with the Private Party, resolving disputes with the Private Party and monitoring the day-to-day management of PPP Agreements.[241] The PPP Agreement should further provide that the Institution must appoint a Project Officer whose main purpose is to manage the Project on behalf of the Institution.[242]

38.2 An integral part of managing the Project is managing the risks associated with the Project by ensuring that the Project is implemented in accordance with the terms of the PPP Agreement. As the Private Party is responsible for the Project, the Institution will not be involved in the day-to-day running of the Project.

[240] This will likely be reinforced in the Regulatory Instruments.

[241] This does not limit the generality of Part P: 70 (*Information and Audit Access*).

[242] The PPP Agreement should refer to the position rather than a named person.

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38.3 It is, however, crucial that the Institution is at all relevant times aware of the development and progress of the Project. The most efficient way of ensuring that this is done under the circumstances is by requiring the Private Party to liaise with the Institution on a regular basis. Such liaison should include the appointment by each Party of a liaison officer (in the case of the Institution this person should be the Project Officer) who would be the primary initial source of contact between the Parties. It should also include regular liaison meetings and reporting obligations whereby the Private Party provides the Institution with regular reports covering the various performance areas included in the Services. These reporting requirements should not limit the generality of the reporting requirements referred to in Part P: 70 (*Information and Audit Access*) which are intended to cover reporting to the Institution in order to enable the Institution to comply with its disclosure and other auditing requirements imposed by law. The reporting referred to in this Section should cover the construction and development phase issues relating to progress of the Works, notice of any anticipated delays, the programme for managing any delays, and other issues of importance during the development phase.[243]

38.4 During the Service Period, the reporting requirements should cover the Private Party's availability and performance failures in relation to the output specifications of the Project.

38.5 The reporting obligations are essential in order to ensure that the Project risks are managed in accordance with the provisions of the PPP Agreement. The consideration of appropriate risk transfer also requires that the Institution ensures that the Private Party, if a company, complies with its obligations in terms of the Companies Ordinance and that the Private Party does not take any

[243] The nature and type of reports required will depend on the specific Project.

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action or omit to take any action that may adversely affect the legal status and financial stability of the Private Party.

38.6 The PPP Agreement must contain detailed provisions relating to the reporting and disclosure obligations of the Private Party. These obligations must mirror the Institution's disclosure obligations to the Accountant-General as well as the Auditor-General.

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PART I: INSURANCE

39 INTRODUCTION

39.1 In traditional "input"-based procurement, government self-insures against those risks retained by it which are not passed on to the private sector. Since, in PPPs, there is substantial risk transfer to the private sector, self-insurance by government is not practical or appropriate. Instead, the insurances required in a PPP will be maintained by the Private Party in order to mitigate the risks transferred to it. Since the Institution's primary concern in a PPP is that the Services remain available, it will need to be satisfied that the insurances maintained by the Private Party provide sufficient cover to enable the Private Party to meet its availability obligations.

39.2 As the Lenders take some performance risk in a project financed PPP, they too will usually have extensive insurance requirements. The Institution should not, however, rely on the Lenders' insurance requirements as an indication of the adequacy of the Private Party's proposed insurances for the Project. Since the insurances required for the Project are generally for the benefit of both Parties and the costs of such insurances are generally passed through to the end users (in the User Charges), the Institution will need to satisfy itself as to the adequacy and affordability of the insurances. Further, the Institution's insurance requirements will extend to the full Project Term, whereas the Lenders' insurance requirements will only extend to the term of the Debt, which is shorter.

39.3 It is essential for the Institution to seek its own insurance advice on the insurance requirements of the Project. This should be done at the feasibility study phase, the bid evaluation phase and the negotiation phase with the successful bidder. In this regard, the Institution should bear in mind that not all risks that the Institution wishes to transfer to the Private Party may be

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insurable. Accordingly, if the Private Party assumes an uninsurable risk it will charge a premium for doing so and this will be reflected in a higher level of User Charges.

39.4 The Institution's insurance advice should focus on whether the risks transferred to the Private Party are insurable on commercially reasonable terms and, to the extent that commercially reasonable insurance cover is not available to cover any such risk, whether the premium that the Private Party will charge for assuming such risk will result in better value for money for the Institution or whether better value for money will be obtained if the Institution assumes and therefore "self-insures" such risk.[244]

39.5 The main issues dealt with in this **Error! Reference source not found.** (*Insurance*) are:

39.5.1 whether the Private Party should obtain and maintain certain insurances as a means of managing particular risks;

39.5.2 how substantial increases in insurance premiums over the Project Term that are not covered by the escalation in the User Charges permitted under the inflation indexation mechanism in the PPP Agreement should be dealt with;

39.5.3 what should happen if any risks that are insurable at the commencement of the Project Term later become uninsurable;

39.5.4 the control of the defence of any litigation relating to an insured event; and

39.5.5 how the proceeds of the insurances should be applied.

[244] In the bid evaluation and negotiation phases of a Project, the insurance advice will also focus on whether the insurance policies for the insurances proposed to be procured by the bidders are market-related or whether they contain unusual exclusions or endorsements.

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40 INSURANCE REQUIREMENTS

40.1 General

40.1.1 The insurance requirements for a Project should reflect, having regard to the particular circumstances of the Project, the degree of risk transfer to the Private Party, the availability of insurances on commercially reasonable terms to cover any risk (relative to the probability of the occurrence, and the likely impact, of such risk) and value for money considerations. Although there are standard insurances that are typically available during the construction and/or operations phases of any Project, nevertheless the scope of these insurances (the risks, the exclusions, the endorsements, the amounts of cover and the deductibles) will vary from project to project and sector to sector.[245] The Institution and its insurance advisors must focus on all these factors when assessing the insurance requirements of the Project.

40.1.2 In order to optimise risk transfer, the Institution should allow the Private Party to manage its insurance arrangements as far as possible. In general terms, the Private Party will be expected to insure in accordance with Good Industry Practice.[246]

40.1.3 There will be a number of insurances, however, which the Institution will want to know are being taken out and maintained by the Private Party, to ensure that the Project will "survive" if certain risks materialise. These insurances should include:

[245] Salient information (being the risks covered, all material exclusions, any endorsements, the amounts covered and all deductibles) on the Project Insurances should be included in a Schedule to the PPP Agreement. This information should be confirmed in writing by a letter(s) of undertaking from the broker appointed to place the Project Insurances.

[246] What constitutes Good Industry Practice for the purpose of the insurances should be part of the advice sought by the Institution from its own insurance advisor.

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40.1.3.1 material damage insurances, business interruption insurances (also referred to as "project delay" insurance in the construction phase of the Project) and fidelity insurance, each for both the construction phase and operations phase of the Project; and

40.1.3.2 the following legal liability insurances*:* third party liability insurance, employer's liability insurance, professional indemnity insurance and motor third party liability insurance. Save for the professional indemnity insurance, each of these legal liability insurances should be obtained for both the construction phase and operations phase of the Project. The professional indemnity insurance is a dedicated once-off policy that is only available for a fixed period (typically, five years) from the commencement of the construction phase.

40.1.4 Generally, the Institution should ensure that the insurances taken out for the Project and paid for through the User Charges do not include any insurance that will not directly benefit the Project. An example of such insurance is directors and officers liability insurance, as the risks associated with the negligent conduct of the directors and officers of the Private Party should be for the Private Party and should not be subsidised by the end users or the Institution through User Charges and/or the Unitary Payment.

40.1.5 Professional indemnity insurance covers the risk of professional negligence resulting in design or engineering defects in the Works. This risk is a Private Party risk, and while the Institution may require that this insurance is maintained by the Private Party because it will put the Private Party in funds to pay for the rectification of such defects and thereby help to ensure the continued delivery of the Services, the

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Institution should not pay for this insurance for to do so will mean the Institution taking back the design and engineering works risk.

40.1.6 Business interruption insurance is necessary to ensure that the Private Party is able to service its Debt obligations and cover its capital and operating expenditure over periods when the Project Deliverables are not being performed (for example, during a Relief Event). This insurance is necessary, therefore, to ensure that the Project is not terminated because of a default under the Financing Agreements. However, the business interruption insurance may also extend to the Shareholders' return on Equity and/or the Shareholder Loans. To the extent that this insurance will compensate for the Shareholders' return on Equity or the repayment of the Shareholder Loans (including interest thereon), the cost of this insurance should not be passed through to the end users and/or the Institution through the User Charges and/or Unitary Payment.

40.1.7 The Institution should be a co-insured for its own interests (where it has an insurable interest)[247] and require that its interests be noted on the policies relating to Project Insurances. The Institution should be aware that the Lenders too would want to be named as co-insureds under the policies for the Project Insurances.

40.1.8 The Institution should consider the value for money benefits of requiring the Private Party to take out non-vitiation protection, if available, in respect of certain Project Insurances (for example, the material damage insurances). Non-vitiation protection allows the Institution to claim as a co-insured under a policy even if the insurer would have been able to avoid a claim made by the Private Party on the basis that the Private Party

[247] The Institution will have insurable interests in relation to most of the insurances. Possible exceptions here are the fidelity insurances, the employers' liability insurances and the motor third party liability insurances. This should be confirmed with the broker appointed to place the insurances for the Project.

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withheld material information from the insurer (for example, the Private Party does not inform the insurer that it is intending to use highly flammable substances).[248] The Institution should obtain specific advice from its own insurance advisor as to what (if any) non-vitiation protection is available.

Standard Clause

<u>Insurance</u>

(a) *The Private Party shall take out and shall thereafter maintain the insurances listed in Schedule [x] and any other insurances in respect of the Project as may be required by law (the "**Project Insurances**"). Each of the Project Insurances listed in Schedule [x] must be taken out and become fully effective not later than the corresponding date set forth in Schedule [x][249]. Each of the Project Insurances (if any) not listed in Schedule [x] must be taken out and become fully effective not later than the earliest date required by law.*

(b) *The payment of the insurance premiums due and payable under the policy applying to any Project Insurance shall be the responsibility of the Private Party.*

(c) *No Party to this PPP Agreement shall take any action or fail to take any action, or (in so far as is reasonably within its power) permit anything to occur in relation to it, which would entitle any insurer to refuse to pay any claim under the policy applying to any Project Insurance.*

(d) *The Private Party undertakes that each Project Insurance shall:*

(i) *without limiting the provisions of Clause (e) below, name the Private Party as the insured;*

(ii) *provide for non-vitiation protection in respect of any claim made by the Institution as co-insured. If non-vitiation protection is unavailable when any such insurance policy is first placed, then the Private Party shall procure that the*

[248] Where an insurance claim is vitiated because of the Private Party's non-disclosure of material information, the Private Party will be obliged to self-fund the loss not covered as a result of the vitiation. Its failure or inability to do so and to reinstate the Project may, depending on the materiality of the damage, be a breach of a material term and expose the Private Party to the risk of termination for Private Party Default.

[249] This date should be the earliest date by when the relevant risk is likely to arise.

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[Insurance Broker] investigates whether any non-vitiation protection subsequently becomes available prior to each renewal of the policy and provides written confirmation promptly upon the renewal thereof as to the unavailability thereof to the Institution. If any non-vitiation protection subsequently becomes available, then the Institution shall be entitled to require the Private Party to procure such protection and the costs thereof shall be borne by the Private Party;[250]

(iii) *contain a clause waiving the insurers' subrogation rights against the Institution, its employees and agents;*[251]

(iv) *provide for [x] days' prior written notice of its cancellation, non-renewal or amendment to be given to the Institution;*

(v) *contain a clause recording that such Project Insurance is a primary insurance and shall not be brought into contribution by any other insurances; and*

(vi) *provide for payment of any proceeds under any of the material damage insurances included in the Project Insurances to be made by the insurers in accordance with Clause [x] (Reinstatement).*

(e) *The Private Party shall procure that each of the Project Insurances shall name the Institution as a co-insured for its separate interest.*[252]

(f) *The Private Party shall furnish the Institution, on request, with:*

(i) *true and complete copies of the policies of all the Project Insurances (together with any other information reasonably requested by the Institution relating to such policies) and the Institution shall be entitled to inspect them during ordinary business hours; and*

(ii) *satisfactory evidence that the premiums due and payable under any such policies have been paid and that the Project Insurances are in full force and effect in accordance with the requirements of this Clause.*

[250] See Section 40.1.8.

[251] This waiver will only be granted in favour of a co-insured and is one of the benefits of being a co-insured. If the Institution cannot be a co-insured under any insurance policy (because it has no insurable interest in such insurance), then appropriate amendments should be made to this provision.

[252] This will only be possible in relation to policies in respect of which the Institution has an insurable interest. If the Institution cannot be a co-insured under any insurance policy (because it has no insurable interest), then appropriate amendments should be made to this provision.

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(g) *The Private Party shall, as and when required pursuant to the terms of the relevant policy,*[253] *renew each Project Insurance for so long as any risk covered thereby exists and shall furnish the Institution with true and complete copies of each certificate of renewal for such Project Insurance as soon as possible but in any event no less than at least 10 (ten) days before the relevant renewal date.*

(h) *If the Private Party breaches Clause (a) or (b) above in relation to any Project Insurance, the Institution may pay any premiums required to keep such Project Insurance in force and effect, or itself procure such Project Insurance*[254] *and may recover all premiums or other costs incurred by it in doing so from the Private Party on written demand.*

(i) *The Private Party shall notify the Institution within [x] days after submitting any claim in excess of PKR[x] (indexed to [CPI]) under any of the insurance policies referred to in this Clause, accompanied by full details of the event giving rise to the claim.*[255]

(j) *Neither the failure to comply nor full compliance with the insurance provisions of this PPP Agreement shall limit or relieve the Private Party of its liabilities and obligations under this PPP Agreement.*

40.2 Variations

If the Institution wishes to change the limits or scope of the Project Insurances during the Project Term, then this should be treated as an Institution Variation (see Part K: 50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)).

[253] Professional indemnity insurance is available for a fixed period (typically five years) and is generally not renewable annually.

[254] This will not be possible for insurances in respect of which the Institution has no insurable interest.

[255] In projects where many claims are likely, the Institution can agree upon a minimum amount below which the Institution is not notified. If this is done, it may be necessary for the Institution to be notified of important claims (for example, accident and injury based claims).

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40.3 Inflationary Increases in Insured Amounts

40.3.1 There must be a mechanism to ensure that the insured amounts increase over the full Project Term in order to keep pace with inflation.[256] This is commonly done through the inflation indexation mechanism.

40.3.2 Index-linking can cause a problem for the legal liability insurances if such insurances cannot be bought in odd amounts although this is normally dealt with by rounding up annually to the nearest whole insurable amount.

40.4 Insurers

40.4.1 The PPP Agreement should require that the Private Party place all the Project Insurances with permitted insurers in accordance with applicable law.

40.5 Changes in Terms of Insurance Policies

40.5.1 The Institution should ensure that the insurers are under an obligation to inform the Institution of changes in the policies in respect of the Project Insurances. This obligation should be confirmed in writing by the insurance broker appointed to place the Project Insurances.

40.5.2 Some insurers may not agree to this. Accordingly, the Institution should also ensure that the PPP Agreement obliges the Private Party to notify the Institution of any such changes and that the insurance broker gives a similar undertaking.

[256] This will not be necessary where the insured amount is an unspecified amount (for example, the reinstatement cost of fixed assets or the market value of movables) rather than a specific sum (as is usually the case for legal liability insurance).

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41 INCREASES IN INSURANCE RATES

41.1 The risk of substantial increases in the rates at which the premiums for the Project Insurances are calculated (not covered by the escalation in the User Charges permitted under the inflation indexation mechanism in the PPP Agreement) should generally be borne by the Private Party. The Institution should ensure that such risk is not passed through to the Institution.

41.2 The only exceptions here are increases resulting from Institution Variations. This risk should be borne by the Institution and taken into account in the price variation provisions. Increases resulting from Variations by the Private Party must be borne by it.

42 RISKS WHICH BECOME UNINSURABLE

42.1 General

42.1.1 The PPP Agreement must address the situation where a risk to be covered by any of the Project Insurances and which was insurable as at the Signature Date subsequently becomes "uninsurable". In this Standardisation "Uninsurability" is defined with reference to the availability of insurance for a particular risk and not the availability of insurance upon particular terms or with particular levels of deductibles.

Standard Definition

*"**Uninsurable**" means, in relation to a risk, either that:*

(a) insurance is no longer available from reputable insurers in the [worldwide insurance market]; or

(b) even if insurance is available from reputable insurers in the worldwide insurance market, the insurance premium payable for insuring that risk has increased to such a level that the risk is no

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longer being insured against in relation to Pakistan in the [worldwide insurance market].[257]

42.1.2 The consequences of the Uninsurability of any risk (ranging from Private Party Default to the grant of Uninsurability relief, which entails the partial assumption by the Institution of the now Uninsurable risk) will depend on:

42.1.2.1 the type of risk;

42.1.2.2 who is responsible for the Uninsurability of that risk; and

42.1.2.3 whether other service providers carrying on similar businesses to the Private Party would cease to carry on business as a result of the Uninsurability of that risk.

42.1.3 Institutions should be aware that the Uninsurability of a risk should not in and of itself be treated as a Private Party Default. If, however, the Private Party has *caused* the risk to become Uninsurable, then this will give rise to a termination right for Private Party Default.

42.2 Types of Risk for which No Uninsurability Relief is Granted

42.2.1 Uninsurability relief may not be extended to all risks covered (or which ought to have been covered) by the Project Insurances.

42.2.2 No such relief may be granted in respect of those risks covered (or which ought to have been covered) by any fidelity insurance, professional indemnity insurance or non-vitiation insurance included in the Project Insurances. The reason for this is that the grant of such relief will undermine the transfer of these risks to the Private Party. If the

[257] Affordability and value for money concerns may be kept in view in choosing between the worldwide insurance market or the Pakistan insurance market..

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Institution were to grant such relief in relation to these risks, the Institution might then be insuring the Private Party against claims relating to the Private Party's (or its Subcontractors') own negligence.

42.2.3 Whether such relief should be granted in respect of those risks covered (or which ought to be covered) by any business interruption insurance should be determined on a project-by-project basis. In the absence of Uninsurability relief for the risks to be covered by the business interruption insurances, the Lenders may require the Private Party (or its Shareholders) to set aside substantial contingency provisions to cover defaults in debt service. This may result in substantially higher bid prices. It may also impact negatively on value for money. If better value for money will be achieved by the grant of Uninsurability relief in relation to such insurance, then the Institution should consider granting such relief. However, such relief must *only* extend to that portion of the business interruption insurance that covers debt service and the Private Party's capital and operating expenditure.

42.3 Other Preconditions for Uninsurability Relief

42.3.1 No Uninsurability relief should be granted in respect of any risk if the Private Party has *caused* the relevant risk to become Uninsurable. This should give rise to a termination right on the part of the Institution for Private Party Default.

42.3.2 No Uninsurability relief should be granted in respect of any risk if other service providers carrying on business similar to the Project would not cease to do so as a result of the Uninsurability of such risk.

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42.4 Uninsurability Relief

42.4.1 If a risk (other than the risks contemplated in Section 42.2) becomes Uninsurable and the preconditions for Uninsurability relief are satisfied, then the Parties should endeavour to agree alternative means by which that risk can be managed. If, however, no such agreement is reached, the PPP Agreement will continue in force but the risk will revert to the Institution. The User Charges must then be reduced by an amount equal to the premiums payable in respect of such risk.

42.4.2 Should the now-uninsured risk then occur, the Institution can choose either to:

42.4.2.1 pay an amount equal to the insurance proceeds that would have been payable had the risk continued to be insurable, in which event the PPP Agreement will continue in force; or

42.4.2.2 terminate the PPP Agreement as if for Force Majeure, and pay to the Private Party compensation equivalent to the amount payable to it on Force Majeure termination.

***Standard Clause*[258]**

<u>Uninsurable Risks</u>

(a) If a risk usually covered by the Project Insurances in Schedule [x],[259] becomes Uninsurable, then the Private Party shall notify the Institution within [x] days of the risk becoming Uninsurable.

(b) If both Parties agree, or it is determined in accordance with Clause [x] (Fast-track Dispute Resolution), that:

[258] See footnote 262.

[259] This Schedule should refer to all the Project Insurances specifically identified by the Parties in the Schedule referred to in Standard Clause (a) in Section 40.1 (*Insurance Requirements*) except those Project Insurances referred to in Section 42.2 (*Types of Risk for which No Uninsurability Relief is Granted*).

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(i) the risk is Uninsurable;

(ii) the risk being Uninsurable is not caused by the actions or omissions of the Private Party or a Subcontractor; and

(iii) other service providers carrying on businesses similar to the Project would cease to do so as a result of such Uninsurability,

then the Parties shall meet to discuss the means by which the risk should be managed (including by way of self-insurance by either Party).

(c) The Private Party shall bear the onus of proving the circumstances in Clause (b)(i) to (iii).

(d) If the requirements of Clauses (a) and (b) are met:

(i) this PPP Agreement shall continue in force and effect;

(ii) the User Charges shall be reduced by an amount equal to the premium previously payable in respect of the Uninsurable risk; and

(iii) on the occurrence of the risk (but only if that risk has continued to be Uninsurable) the Institution shall, at the Institution's option, either pay:

(aa) to the Private Party an amount equal to the insurance proceeds that would have been payable[260] had the risk continued to be insurable, in which event this PPP Agreement will continue; or

(bb) an amount equal to the amount set out in Clause [x] (Compensation on Termination for Force Majeure) and this PPP Agreement will terminate as if for Force Majeure.[261]

[260] The Institution should therefore deduct all deductibles that could have been made had the insurance continued to be in place.

[261] See Part N: 61(*Termination: Compensation on Termination for Force Majeure*).

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42.5 Uninsurability Relief in respect of Third Party Claims

42.5.1 The Private Party may be concerned in relation to Uninsurable third party claims, that in the standard approach described in Section 42.4 above a substantial amount of time may pass between the time when Uninsurability has been established and the time when the Institution makes its election (which will only be when the Uninsurable event actually occurs), and that for this entire period its directors and officers will not know whether the PPP Agreement will be terminated for Force Majeure or whether the Uninsurable third party claims will be paid out by the Institution.

42.5.2 In projects where there is a high risk of substantial third party claims, the bidders may take the view that this approach will expose their directors and officers to claims of poor corporate governance or even reckless conduct, that is, the reputations of directors and officers may be impugned in so far as they are "seen" to be managing a business which has no third party insurance in place.

42.5.3 In such projects, the Institution should consider whether better value for money will be achieved if its election (to terminate the PPP Agreement or pay out the third party claims) is made at the time when the Uninsurability of the third party claims is established. At this point, the PPP Agreement will terminate for Force Majeure, unless the Institution then agrees that it will pay out future third party claims in which event the PPP Agreement continues. In this way, the Private Party's directors and officers will have the comfort of knowing (where the PPP Agreement continues) that the Uninsurable risk will be borne by the Institution.

42.5.4 If the above approach is taken, it is critical that the Institution retains the option to terminate the PPP Agreement in the future (as if for Force

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Majeure) if, at any time after an Uninsurable third party claim is made, the Institution comes to the conclusion that the continuation of the PPP Agreement is untenable.

42.5.5 If the Institution does decide to "delay" its decision to terminate the PPP Agreement until after the first or even later occurrences of the Uninsurable risk, then the Institution will have to pay out the full Force Majeure termination compensation even though it may already have paid out substantial third party claims, so such a delay might not prove to be cost-effective. This should be borne in mind by the Institution at the time when the election has to be made.[262]

43 CONTROL OF THE DEFENCE IN LITIGATION ON AN INSURED EVENT

43.1 The Institution may wish to control the defence of any litigation against the Private Party that is likely to have implications for the Institution itself or wider government. If the Institution is likely to become a co-defendant in the relevant litigation or a defendant in a number of similar litigation proceedings based on the precedent in law set by the relevant litigation, it is likely to want to control the litigation from an early stage. This may involve prolonging litigation in order to establish a clear precedent instead of settling out of court. Alternatively, the Institution may wish to settle the litigation as soon as possible for public policy reasons and, in such cases, these will override commercial considerations (this may be the case, for example, in prison and hospital projects).

43.2 Insurers will, however, usually expect to be in control of any litigation which may lead to a claim under one of their policies. They will be reluctant to pay out for claims where they have no control of the defence. The degree of

[262] The Standard Clause above will have to be appropriately amended if the approach in this Section 42.5 is adopted.

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control required by the Institution should be examined on a project-specific basis and advice in this regard should be sought by the Institution from its insurance advisor.

43.3 Generally, the Institution should expect to assume some liability for litigation costs if it wishes to insist on controlling such litigation. In practice, it is extremely difficult to determine what such liability should be. In principle, the Institution should be liable for any difference between what the insurer would have paid and the final amount settled or decided. It would be very hard to establish, however, what amount would have been an acceptable settlement to all parties (including the plaintiff). In practice, the Institution may find that it is obliged to take on the majority, or even all, of the relevant litigation costs in return for the right to control the defence.

44 APPLICATION OF INSURANCE PROCEEDS

44.1 Material Damage Insurance

Reinstatement

44.1.1.1 Material damage insurance policies typically allow for exact reinstatement of the assets following an insured event.

44.1.1.2 Where the insurance proceeds fall short of the full cost of reinstatement and this shortfall is due to under-insurance by the Private Party, this shortfall must be funded by the Private Party.[263]

44.1.1.3 The Institution may, however, decide to change the Services following an insured event and this may entail something other than exact reinstatement, which may cost more than exact

[263] Institutions should nevertheless confirm in advance with the insurance broker appointed to place the Project Insurances whether the material damage insurances will cover the full reinstatement costs. This confirmation should be obtained in writing and included in the broker's letter of undertaking.

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reinstatement. Where the insurance proceeds do not cover the full cost of "reinstatement" and the additional cost is due to an Institution Variation, then the extra cost must be funded by the Institution in accordance with the variation in Services mechanism (see Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)). Although the material damage insurances should at least always provide for exact reinstatement, the Private Party should nevertheless be required to negotiate these insurances on terms that permit something other than exact reinstatement if the Institution elects to change the Services.[264]

44.1.1.4 The PPP Agreement must oblige the Private Party to prepare and deliver a reinstatement plan setting out the scope of works that the Private Party will need to undertake to reinstate the Project Assets, the timeline for such works and details of the subcontractor who will undertake those works (if this person is not the Construction Subcontractor). In practice, however, following the occurrence of an insured event the Parties will sit down and negotiate whether and, if so, how to reinstate the Project Assets. Accordingly, the PPP Agreement should also set out provisions governing the process the Parties will follow when negotiating the reinstatement of the Project Assets. The Institution should ensure that the PPP Agreement clearly sets out what should happen in the event of any disputes over any reinstatement plan. The Institution should also ensure that all material damage insurance proceeds are utilised in accordance with the agreed reinstatement plan.

[264] If the Institution decides to reinstate with a lower Services level, then the User Charges should remain the same unless compensation is paid to the Private Party. The Institution should also be aware of the fact that a decision not to reinstate fully may impact upon the amount of insurance proceeds recoverable.

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44.1.1.5 Even if the insured event is one which would normally entitle the Institution to terminate the PPP Agreement, the Institution's termination right should be suspended if a reinstatement plan has been adopted and the reinstatement works are being properly carried out in accordance with that plan. If the Private Party does not comply with the reinstatement plan, then the suspension of the Institution's rights of termination should be lifted.

44.1.1.6 The Institution must ensure that upon termination of the PPP Agreement for whatever reason, the Institution receives the benefit of any such insurance proceeds so that it can proceed with or continue the reinstatement of the Project Assets.[265] In many instances, the Private Party will be forced to replace or reinstate prior to the settlement of the insurance claim. It may therefore be prudent to stipulate that the proceeds of the insurance shall be applied for the benefit of the Project if no longer directly applicable to the insured event in terms of the reinstatement plan.

Standard Clause

Reinstatement

(a) *[Subject to Clause [x] (Economic Test)],*[266] *all insurance proceeds received under any policy referred to in Part [x] of Schedule [x] ("**Material Damage Policies**") shall be applied to repair, reinstate or replace each part or parts of the Project Assets in respect of which the proceeds were received.*[267]

(b) *All insurance proceeds paid under any Material Damage Policy in respect of a single event or a series of related*

[265] This is particularly important if the PPP Agreement is terminated for Private Party Default and the Institution elects (and is able) to retender the PPP Agreement.

[266] The application of this test will only be appropriate in certain projects. If this test is not appropriate then the bracketed phrase must be deleted. In this regard see Section 44.1.1.8.

[267] The Private Party will be liable to make good any deductibles in terms of such policies.

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*events shall be paid into a bank account to be opened in the name of both Parties (the "**Joint Insurance Account**").*[268]

(c) [Subject to Clause [x] (Economic Test)][269]*, where a claim is made or proceeds of insurance are received or are receivable under any Material Damage Policy in respect of a single event or a series of related events:*

*(i) the Private Party shall deliver as soon as practicable and in any event within [x] days after the making of the claim, a plan (the "**Reinstatement Plan**") prepared by the Private Party for the carrying out of the works necessary (the "**Reinstatement Works**") to repair, reinstate or replace the Project Assets which are the subject of the relevant claim or claims in accordance with Clause (d) below. The Reinstatement Plan shall set out:*

(aa) if not the Construction Subcontractor, then the identity of the person proposed to effect the Reinstatement Works, which shall be subject to the prior written agreement of the Institution; and

(bb) the proposed terms and timetable upon which the Reinstatement Works are to be effected (including the date that the Project will become fully operational), the final terms of which shall be subject to the prior written agreement of the Institution,

provided that if the Parties fail to reach any such agreement, then the dispute shall be referred for resolution by [the Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution); and

(ii) if the Institution is satisfied[270] *that the Reinstatement Plan (as amended by agreement with the Institution or in accordance with the*

[268] This account must be excluded from the Lenders' security regime, although the Lenders (or their agent) may be co-insureds under these policies.

[269] See footnote 266.

[270] The Institution should be aware that following any material damage to the Project, the Private Party will only be permitted to claim under any business interruption insurance if the insurer is satisfied that the Private Party is using its reasonable endeavours to reinstate. Accordingly, the Institution's response to the proposed Reinstatement Plan should be reviewed by the Institution as a matter of priority and the Institution should respond to the Private Party within a reasonable period of time.

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decision of [the Independent Expert]) will enable the Private Party to comply with Clause (d) below within a reasonable timescale, then:

(aa) the Reinstatement Plan shall be adopted;

(bb) the Private Party shall enter into contractual arrangements to effect the Reinstatement Works with the person agreed to by the Institution;

*(cc) prior to the earlier to occur of the Termination Date and the Expiry Date, any amount standing to the credit of the Joint Insurance Account together with any interest accrued (the "**Relevant Proceeds**") may be withdrawn by the Private Party to the extent required to enable it to make payments in accordance with the terms of the contractual arrangements referred to in Clause (ii)(bb) above, and to meet any other reasonable costs and expenses of the Private Party for the sole purposes of funding the Reinstatement Works. Following the earlier to occur of the Termination Date and the Expiry Date, the Institution may withdraw the Relevant Proceeds for the purposes of funding any Reinstatement Works;*

(dd) the Institution agrees and undertakes that, subject to compliance by the Private Party with its obligations under this Clause, and provided that the Private Party procures that the Reinstatement Works are carried out and completed in accordance with the contractual arrangements referred to in Clause (bb) above, it shall not exercise any right which it might otherwise have had to terminate this PPP Agreement by virtue of the event which gave rise to the claim for the Relevant Proceeds; and[271]

[271] If the insured event is a Relief Event, the Institution would not have any termination rights in respect of such event. However, the Institution would be entitled to terminate the PPP Agreement if the event is a Private Party Default. During a reinstatement period, however, that termination right should be suspended, but the provisions relating to Compensation Events, Relief Events and Variations should continue to apply.

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(ee) after the Reinstatement Plan has been implemented to the reasonable satisfaction of the Institution and in accordance with Clause (d) below, the Institution shall permit the withdrawal by the Private Party of any Relevant Proceeds that have not been paid under Clause (cc) above.

(d) Where insurance proceeds are to be used in accordance with this PPP Agreement to repair, reinstate or replace any Project Asset forming part of the Works, the Private Party shall carry out the Reinstatement Works or procure that such works are carried out in accordance with the [construction specification] so that on completion of the Reinstatement Works, the provisions of this PPP Agreement are complied with.

Economic Test

44.1.1.7 The Private Party should always be obliged to reinstate the damaged Project Assets if an insured event occurs.[272]

44.1.1.8 In some projects, the Lenders will want to impose an "economic test" to determine whether reinstatement will enable them to recover the Debt in full. If the economic test shows that this is not possible, then the Lenders will prefer to appropriate the insurance proceeds to service the Debt instead of allowing the proceeds to be applied in reinstatement of the Project Assets. This allows the Lenders to exit from the Project, although the Private Party and its Shareholders will remain in the Project.

44.1.1.9 Resort to an "economic test" is, however, only appropriate where there is a high risk of total destruction of the Project Assets and a lengthy reinstatement period. The decision by an Institution to

[272] It is standard in the insurance industry for the insured amount in relation to fixed assets to cover their full replacement value as opposed to their market value.

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subject the reinstatement process to the Lenders' economic test should only be made if this will ensure better value for money.[273]

44.1.1.10 If an economic test is agreed to, it must be based on a loan life cover ratio[274] so that the Lenders cannot exit from the Project if the test shows that debt service is still achievable (even if there is hardly any cushion above the ratio) over the remaining period to the final maturity date of the Debt. The use of an annual debt service cover ratio as an economic test is inappropriate as this ratio contains only an annual "snapshot" of performance, which is not relevant.[275]

44.1.1.11 The economic test involves a comparison of the amount of the Debt with the amount of the future Project revenues forecast to be earned if the insurance proceeds are applied in reinstatement and the reinstatement is carried out. The length of the remaining Project Term and the time required to reinstate the Project Assets (during which time and depending on when in the Project Term the insured event has occurred and the extent of the damage, the User Charges may not be billed and collected in full or at all) are critical factors in the application of this test. The object of the test is to establish whether the full Debt will be recoverable from the Project revenues.

[273] In projects where there is a low risk of total destruction of the Project Assets (for example, where the Project Assets are spread across a wide area, as will be the case in a road project) there should be no resort to such a test.

[274] If this is being calculated during the Service Period and no further drawdowns are possible, then this is calculated by *dividing*: (a) forecast net revenues until the final maturity date of the Debt (including User Charges and the proceeds of business interruption insurance), discounting back future revenues to the date of calculation (at the interest rate payable under the Debt) and assuming that the damaged Project Assets have been reinstated; by (b) the Debt outstanding less all credit balances, each as at the date of calculation. If further drawdowns can be made, then this calculation should take into account actual drawdowns plus all undrawn commitments to the extent forecast in the Financial Model.

[275] There should be no need to specify a threshold amount of insurance proceeds below which the economic test should not be applied because the test should, in any event, only be applied in cases of total or near total destruction.

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44.1.1.12 If the economic test shows that the full Debt will be recoverable after the insurance proceeds are applied in reinstatement of the Project Assets, then the insurance proceeds must be so applied in accordance with the pre-agreed reinstatement plan.

44.1.1.13 If the economic test shows that the full Debt will not be recoverable as aforesaid, then the Lenders should be permitted to apply the insurance proceeds or an amount equal to the Debt (whichever is the lesser) towards prepayment of the Debt and the Private Party must remain under an obligation (to the Institution) to reinstate the Project Assets. If, as is likely, the Private Party is not financially able to do so, then it will be in breach of the PPP Agreement and the Institution may terminate for Private Party Default in the usual way. The Institution can then rebuild the asset through a new tender.

44.1.1.14 The Private Party's funders may propose that the utilisation of the insurance proceeds should depend on who caused the insured event, so that if the Institution caused the insured event then the insurance proceeds must be released for the benefit of the Lenders and, to the extent that these proceeds exceed the Debt, for the benefit of the Shareholders. In this scenario, the Project would probably go into default because the Private Party will lack the funds to reinstate the Project. However, this fault-based approach is inappropriate. The material damage insurances will have been paid for by the end users (through the User Charges) to reinstate the Project Assets following an insured event and thereby ensure the continued provision of the Services (effectively for the benefit of both Parties) regardless of the circumstances giving rise to the insured event. Accordingly, if the insurance proceeds are

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sufficient to reinstate the Project Assets and such reinstatement will not impact on debt service over the originally envisaged repayment period, then the Lenders and the Shareholders should not be allowed to exit. In any event, the Institution is itself not entitled to terminate the PPP Agreement (even if the insured event is a Private Party Default) where the Private Party reinstates the Project Assets.

44.1.1.15 The Private Party's funders may also propose that if the insurance proceeds are not sufficient to fully reinstate the Project Assets, then the PPP Agreement should permit the Private Party to raise further capital from its funders and to extend the Service Period to the extent necessary to repay such capital and any return thereon. This approach must not be adopted because under-insurance is a Private Party risk. In addition, the further capital injections will increase the Institution's termination compensation liability above that forecast in the base case Financial Model. Furthermore, Service Period extensions will create budgetary uncertainties in Hybrid IPPs and also allow the Shareholders to achieve a full return on the capital invested by them even where the insured event that triggered the extension is a Private Party Default.

***Standard Clause*[276]**

Economic Test

(a) If all or substantially all of the Project Assets are destroyed or substantially destroyed in a single event or a series of related events and the insurance proceeds (when taken together with any other funds available to the Private

[276] This Standard Clause is only appropriate if there is a high risk of total destruction of the Project Assets.

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Party)[277] are equal to or greater than the amount required to repair, reinstate or replace the Project Assets, then the Private Party[278] shall calculate[279] the [loan life cover ratio] in accordance with the Financing Agreements (on the assumption that the Project Assets are repaired or reinstated in accordance with this PPP Agreement).

(b) If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is greater than or equal to the [event of default level],[280] then the Private Party shall apply the insurance proceeds in accordance with the Reinstatement Plan set out in Clause [x] (Reinstatement).

(c) If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is less than the [event of default level], then an amount equal to the lesser of:

(i) the amount of the insurance proceeds; and

*(ii) the amount of the Debt **less**, to the extent that it is a positive amount, the aggregate, as at the date of calculation, of:*

(aa) all credit balances on any bank accounts held by or on behalf of the Private Party and the value of any right of the Private Party or the Lenders to receive insurance proceeds or any proceeds pursuant to letters of credit and of any such proceeds actually received by them (save where such credit balances or proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;

(bb) all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the

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[277] Such funds could, for example, include sums made available to the Private Party by the Institution to ensure that the test is passed and that, as a result, reinstatement occurs in accordance with Section 0 (*Reinstatement*).

[278] The Lenders will control the calculation in terms of the Financing Agreements. The Institution must review the Financing Agreements to establish how the loan life cover ratio is to be applied.

[279] There will be a debate as to how this should be done. Since the Lenders' interests are being protected here, the formulae set out in the Lenders' financial model provided for in the Financing Agreements should be used.

[280] That is the loan life cover ratio as provided in the Financing Agreements, below which an event of default will be triggered under the Financing Agreements entitling the Lenders to accelerate the Debt.

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Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements; and

(cc) the market value of any other assets and rights of the Private Party or the Lenders (other than those that are transferable to the Institution pursuant to this PPP Agreement) less liabilities of the Private Party or the Lenders properly incurred in connection with this PPP Agreement; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(A) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and

(B) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms,

shall be released from the Joint Insurance Account to the Private Party and shall be applied by the Private Party towards the prepayment of the Debt; provided, however, that such release shall not discharge the Private Party from performing the Project Deliverables in accordance with this PPP Agreement.[281]

44.2 Other Project Insurance

44.2.1 In the case of any legal liability insurance, the Private Party should be obliged to apply the proceeds of any claim made under such insurance either in satisfaction of the liability in respect of which such claim is

[281] This will mean the amounts are released to the accounts secured to Lenders and the Lenders will apply such amounts as a prepayment against Debt.

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made, or to reimburse the Private Party to the extent that the liability has already been paid by it out of other Project revenues.

44.2.2 The Private Party should be obliged to apply the proceeds of any business interruption insurance in payment of any capital and operating expenditure incurred by the Private Party in performing the Project Deliverables in the reinstatement period, and the balance in service of the Debt payments becoming due and payable in that period. The PPP Agreement should prohibit the Private Party from applying any such proceeds in repayment or payment of Shareholder Loans or to cover any return on Equity.

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PART J: RELIEF EVENTS, COMPENSATION EVENTS AND FORCE MAJEURE

45 INTRODUCTION

45.1 The Private Party usually undertakes to ensure Service Commencement by a particular fixed date[282] and to continue to provide the Services for the duration of the PPP Agreement. There may, however, be events which result in the Private Party, through no fault on its part or otherwise attributable to it, being unable to meet this obligation. In these circumstances, the Private Party should be excused from liability for failure to commence or provide the Services. A balance must, however, be attained between encouraging the Private Party to manage the risk and protecting the Institution from non-performance.

45.2 These events can be divided into three broad categories:

45.2.1 Relief Events: These are events which may arise at any stage during the Project Term which are best managed by the Private Party (although not necessarily in its control) and for which the Private Party bears the financial risk, but in respect of which neither liquidated damages nor rights of termination should arise (see Section 46 (*Relief Events*)).

45.2.2 Compensation Events: These are events that are clearly at the Institution's risk and in respect of which the Private Party should be compensated (see Section 47 (*Compensation Events*)).

45.2.3 Force Majeure Events: These are a limited set of events which may arise during the Project Term through no fault of either Party, which are best managed by the Private Party (although not in its control) and in respect

[282] The typical structure in PPPs is to require the Private Party to ensure Service Commencement either by the scheduled date for the completion of construction or at any time from the Signature Date, but by the Long Stop Date (see Part E: (*Duration and Service Commencement*)).

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of which rights of termination can arise (see Part N: 61 (*Termination: Compensation on Termination for Force Majeure*)).

45.3 The distinction between Relief Events and Compensation Events (at least during the construction phase) is sometimes expressed as being the difference between the Private Party being given "time" only and "time and money". Force Majeure is, however, a different category of event and is dealt with alongside other termination-related issues (see Part N:61 (*Termination: Compensation on Termination for Force Majeure*)).

45.4 Certain of these events may be dealt with differently depending on the nature of the Project, the likelihood of the event occurring and the value for money obtained if the Private Party prices into its bid the risk of such event occurring. Given that Compensation Events result in the Institution paying money to the Private Party, this should only be incorporated after careful consideration of the Institution's specific obligations in each project. For example, in a Project in which the Responsible Authority's use of the Project Site during the construction phase means that there is a high risk of delays occurring during the construction phase, the Institution may accept that these delays should be Compensation Events. In a Project where such risks do not exist, the Parties may agree that a Relief Event is the most appropriate way to deal with that risk. The risk of discovery of fossils or antiquities during the construction phase may result in a Relief Event to the extent that they could not have been discovered by the Private Party through the exercise of reasonable due diligence (as is suggested in Part D:15 (*Project Site: Heritage Resources*)).

45.5 Similarly, the risk of planning delays may result in a Relief Event to the extent that such delays are not due to any fault or failure on the part the Private Party. As far as the discovery of adverse ground conditions and historic contamination is concerned, this should not usually be at the Institution's risk

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as the Private Party should have carried out appropriate surveys in relation to such matters prior to signing the PPP Agreement and can often assess and accept such risks more economically than the Institution is able to do. The situation may be different in specific circumstances such as where the Private Party has been prevented from carrying out appropriate surveys or it is not affordable or good value for money for surveys to be undertaken (for example, because of the number of sites involved in the Project).[283]

46 RELIEF EVENTS

46.1 Purpose and Scope

46.1.1 Relief Events are events which prevent performance by the Private Party of its obligations at any time, in respect of which the Private Party bears the financial risk in terms of increased costs and reduced revenue but for which it is given relief from termination for failure to provide the full Services and relief from liquidated damages (or draws on the construction bond) for late Service Commencement, if any. The events listed in the standard definition below may be outside the Private Party's control, but that is not the only appropriate measure of whether an event should appear on the list since many events beyond the Private Party's control at the time they occur may in fact have been prevented by proper precautions (for example, fire). Relief Events should cover those events, the risk of which is better borne by the Private Party as it is in a better position than the Institution to mitigate and manage the consequences. This mitigation and management could be in the form of insurance, a combination of insurance and proper planning, or by risk management and planning (that is, the events can be worked around while they exist).

[283] See Part C: (*General Obligations)* and Part D: (*Project Site*).

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46.1.2 Termination should not follow a Relief Event. This is because any replacement Private Party would be similarly affected and so the Institution's position would not be improved by termination. Relief Events do not, however, require the same treatment as Force Majeure events (see Part N: 61(*Termination: Compensation on Termination for Force Majeure*)) as their consequences are not likely to be as severe and will usually only last for a finite period.

46.1.3 It may be argued that a right to terminate should exist if a Relief Event continues for a prolonged period. Other than in certain critical projects[284] or in the case of the discovery of any unforeseen heritage object[285] this is not recommended for two reasons. First, because this may not sufficiently incentivise the Private Party to manage the risk (depending on any compensation payable on termination) and second, because the occurrence of such an event is likely to be of a limited duration (for example, strikes by a supplier) and/or lead to an alternative sourcing of the supply concerned by the Private Party (for example, any shortage of fuel).

Standard Definition

"***Relief Event***" *means:*[286]

(a) any fire, explosion, tempest, flood, ionising radiation (to the extent it does not constitute an event of Force Majeure), earthquakes, riot and civil commotion, or pressure waves caused by devices travelling at supersonic speed;

(b) (without limiting the obligations of the Private Party regarding service level specifications) any failure by the Institution or any

[284] In the interests of certainty in particular projects, for example, where the Services are needed for a hospital, a right to terminate should exist for both Parties in the event of prolonged occurrence of a Relief Event.

[285] It is recommended that should these result in a prolonged delay, the Parties should meet in order to ascertain the best way of continuing with the Project, given the circumstances.

[286] This list can be modified for specific sectors (for example, the unintentional introduction of a virus in an IT project) provided that the commercial risk of the occurrence of such events is still with the Private Party.

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Responsible Authority, utility or other like body to carry out works or provide services;

(c) any accidental loss or damage to the Works and/or the Facilities;

(d) any off-site failure or shortage of power, fuel or transport;

(e) any blockade or embargo which does not constitute an event of Force Majeure;

(f) the discovery of any heritage objects or resources that could not reasonably have been discovered by proper due diligence as contemplated in Clause [x] (Project Site Conditions);[287]

(g) any delay in obtaining any Consent; or

(h) any official or unofficial strike, lockout, go slow or other such labour disputes generally affecting the [x] industry[288] *or a significant sector of it,*

unless any of the events listed in Clauses (a) to (h) inclusive arises (directly or indirectly) as a result of any negligence, wilful conduct or default of the Private Party or any Subcontractor.

46.2 Consequences

46.2.1 The financial effects of delays caused by Relief Events are borne by the Private Party. As such, when these delays occur the Institution should pay no compensation. If a Relief Event occurs prior to Service Commencement, any Long Stop Date will be extended by a period equal to the relevant delay. In most cases the only relief given will be relief from termination and from liquidated damages for late completion of the Works, if any.

46.2.2 There should be no extension to the Project Term due to a Relief Event as such extension poses an unacceptable degree of risk for the Institution. This is because if an extension were given, then although the Private

[287] See Part D:15 (*Project Site: Heritage Resources*).

[288] This will be the principal industry relating to the Project. For example, in an accommodation Project, this will include the building maintenance or facilities management industries.

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Party does not receive the User Charges during a Relief Event (save to the extent the Services are available),[289] the Expiry Date would be extended by the duration of the Relief Event and the Private Party's revenue period would be kept whole. If an extension is given then there may be a reduced incentive on the Private Party to manage the effects of the Relief Event and restore the Services as soon as possible. In addition, the Institution's exposure to any risk it bears under the PPP Agreement is extended indefinitely as the Expiry Date may be continually extended. By extending the PPP Agreement, therefore, the Institution could be taking a substantial element of the risk of the occurrence of Relief Events.

46.2.3 The Private Party should be relieved of any liability for liquidated damages (or draws on the construction bond) for late completion of the Works, although Penalty Deductions should continue to be made where necessary in respect of the period of delay caused by the Relief Event (see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) and Part H: (*Payment and Financial Matters*)).

46.2.4 When a Relief Event has occurred and the Institution has been informed, the Parties should consult on relevant issues, such as the likely duration of the Relief Event and the action to be taken to mitigate its effects. In the event of the discovery of any unforeseen heritage object or resources that result in a prolonged delay it may be necessary to provide for a mechanism by which the Parties can meet in order to find a solution that attempts to salvage the Project while being mindful of the impact of such prolonged Relief Event on the Private Party and the Project.

[289] This must be read in conjunction with Part H: (*Payment and Financial Matters*).

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46.2.5 The Institution should not normally expect to exercise any step-in rights simply because of the occurrence of a Relief Event (see Part O: (*Step-in*)). If the Private Party is not using reasonable endeavours to remedy matters and mitigate the consequences, it will not obtain the relief afforded by Relief Events (which should always be subject to the Private Party's obligation to mitigate) and will be at risk of termination for Private Party Default. This should provide a sufficient incentive for the Private Party to perform (depending, in part, on the approach taken to relief from other obligations under the PPP Agreement).[290]

Standard Clause

Consequences of a Relief Event

(a) If and to the extent that a Relief Event:

(i) directly causes a delay in Service Commencement; and/ or

(ii) materially adversely affects the ability of the Private Party to perform any of its obligations under this PPP Agreement,

then the Private Party shall be entitled to apply for relief from any rights of the Institution arising under Clause [x] (Termination for Private Party Default) and Clause [y] ([Liquidated Damages][Construction Bond])[291].

(b) To obtain relief, the Private Party must:[292]

(i) as soon as practicable, and in any event within [x] days after it became aware that the Relief Event has caused or is likely to cause delay and/or materially adversely affect the ability of the Private Party to perform its other obligations, give to the Institution a notice of its claim for relief from its obligations under this PPP Agreement, including full

[290] How long "prolonged" is will depend on the particular Project. It should in any event not be less than six months.

[291] Generally, Relief Events should give only relief from the risk of termination for failure to achieve Service Commencement or perform the Services and relief from liquidated damages to the extent payable to the Institution. The performance regime should still apply so that Penalty Deductions may still accrue (save for termination purposes) and this should be made clear.

[292] The approach here is to set out a quick procedure so that relief can be given or refused on a sensible timescale without additional delays.

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details of the nature of the Relief Event, the date of occurrence and its likely duration;

(ii) within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details of the relief claimed; and

(iii) demonstrate to the reasonable satisfaction of the Institution that:

(aa) the Private Party and its Subcontractors could not have avoided such occurrence or consequences by steps which they might reasonably be expected to have taken, without incurring material expenditure;

(bb) the Relief Event directly caused the delay to the Scheduled Service Commencement Date [or the need for relief from other obligations under this PPP Agreement];

(cc) the time lost and/or relief from the obligations under this PPP Agreement claimed could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice, without incurring material expenditure; and

(dd) the Private Party is using reasonable endeavours to perform its obligations under this PPP Agreement.

(c) In the event that the Private Party has complied with its obligations under Clause (b) above, then:

(i) the Scheduled Service Commencement Date shall be postponed by such time as shall be reasonable for such a Relief Event, taking into account the likely effect of delay; and/or

(ii) the Institution shall not be entitled to exercise its rights to terminate this PPP Agreement under Clause [x] (Termination for Private Party Default) or its right to [claim liquidated damages under Clause [y] (Liquidated Damages)][draw on the Construction Bond] [and, subject to Clause (d) below, shall give such other relief as has been requested by the Private Party and agreed between the Parties or decided pursuant to Clause [x] (Fast-track Dispute Resolution)].

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(d) [Nothing in Clause (c) above shall affect any entitlement to make Penalty Deductions[293] or any deductions made as a result of [Part H: (Payment and Financial Matters)] during the period in which the Relief Event is subsisting].

(e) In the event that information required by Clause (b) above is provided after the dates referred to in that Clause, then the Private Party shall not be entitled to any relief during the period for which the information is delayed.

(f) The Private Party shall notify the Institution if at any time it receives or becomes aware of any further information relating to the Relief Event, giving details of that information to the extent that such information is new or renders information previously submitted materially inaccurate or misleading.

(g) In the event of a Relief Event stipulated in Clause [x][294] that continues for a period in excess of [x][295] the Parties shall meet in order to find a mutually satisfactory solution for dealing with such prolonged Relief Event.

(h) If the Parties cannot agree on the extent of the relief required, or the Institution disagrees that a Relief Event has occurred or that the Private Party is entitled to any [extension of the Scheduled Service Commencement Date and/or relief from other obligations under this PPP Agreement], the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).

47 COMPENSATION EVENTS

47.1 Purpose and Scope

47.1.1 Compensation Events are designed to cater for delays which arise before the Service Commencement Date as a result of an Institution breach and which result in a delay to Service Commencement and/or increased costs to the Private Party. Compensation Events also cover increased costs

[293] Penalty Deductions that accrue as a result of a Relief Event should be suspended in relation to the Institution's right to terminate the PPP Agreement, but not in relation to the Institution's right to make Penalty Deductions.

[294] This refers to Relief Events involving the discovery after the Signature Date of any heritage resource that could not have been discovered earlier through the exercise of reasonable due diligence (as contemplated in Part D:15.3 (*Project Site: Heritage Resources*)). It does not refer to the discovery of any existing building or infrastructure on the Project Site that is a protected heritage resource as the heritage status of all existing buildings and infrastructure on the Project Site is a Private Party risk (see Part D:15.2 (*Project Site: Heritage Resources*)).

[295] This will depend on the specific project. A period (usually not longer than 180 days) must, however, be inserted.

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during the Service Period as a result of any breach by the Institution of its obligations during the Service Period (which includes a breach occasioned by third parties for whom the Institution is responsible, such as teachers or doctors). Such events are more appropriately dealt with by compensating the Private Party as opposed to constituting Institution Default. As mentioned in Part J: (*Relief Events, Compensation Events and Force Majeure*), it may, after careful consideration in certain projects, be appropriate to add other (or sector) specific events.

47.1.2 The Institution should carefully consider the nature of its obligations during the Service Period. If the Institution has significant ongoing obligations and breach of such obligations would adversely affect the Private Party's ability to perform (for example, if the Institution failed to carry out procedures for certifying operating matters) or affect the cost of performance, then such breaches should result in a Compensation Event for which the Institution should compensate the Private Party, unless such breach is expressly compensated for elsewhere in the PPP Agreement.[296]

Standard Definition

*"**Compensation Event**" means any breach by the Institution of any of its obligations under this PPP Agreement (save for any breach that constitutes an Institution Default) to the extent in each case that the breach is not caused or contributed to by the Private Party or any Subcontractor.*

47.2 Consequences

47.2.1 The practical consequence of a Compensation Event occurring during the Works phase is that the Service Commencement Date will need to be postponed, usually by the length of any delay caused (any Long Stop

[296] The Private Party is also entitled to compensation from the Institution in respect of any indemnities given by the Institution; (see Part C:9 (*General Obligations: Indemnities and Claims for Damages*)); Institution Variations (see Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)); and Unforeseeable Conduct (see Part K:49 (*Unforeseeable Discriminatory Government Conduct and Variations: Unforeseeable Discriminatory Government Conduct*)).

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Date will similarly be extended). This means that the start date of the Private Party's revenue stream is also delayed and/or additional costs are incurred (subject to the Private Party's obligation to mitigate). A Compensation Event which occurs after Service Commencement may result in the Private Party's revenue stream being reduced or interrupted and/or additional costs being incurred. As a result, the Private Party may incur finance charges and additional costs which could involve the Private Party in significant expense.

47.2.2 The Parties must agree how to compensate the Private Party for any delay in Service Commencement or reduction or interruption of its revenue stream or additional costs incurred by it which result directly from a Compensation Event. The prescribed approach is to retain the original Expiry Date and compensate the Private Party for its loss. If possible, a set of financial and other tests may be agreed by the Parties at the Signature Date in order to calculate the compensation payable for possible categories of compensation. The Private Parties will usually demand that the measure of compensation should be the forecast revenues (derived from the Financial Model) for the duration of the delay in Service Commencement. This demand must be resisted for it means a re-transfer of the market or demand risk to the Institution, which is for the Private Party in User Pay PPPs. An objective assessment of the additional costs incurred by the Private Party and compensation in like amount is preferred, where it gives value for money[297]. On the other hand, the Institution's budgetary constraints may prevent it agreeing upfront to compensate the Private Party in lump sum for these additional costs. In such cases, if the Service Period is not to be increased, then the

[297] During the Service Period, this will however equal the Private Party's revenues derived from user charges as in the case of toll roads, where the charge may only be levied when the Services have been rendered.

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only options would be for the Institution to agree to an increase to the User Charges (to make whole the Private Party's revenues) or an extension in the Service Period for the corresponding period. An increase in the User Charges should generally not be agreed to, unless the Compensation Event is of such a nature that significant additional costs not factored in the Financial Model are incurred (for example, failure of the Institution to provide land that necessitates purchase of substitute land by the Private Party) and the Institution for reasons of budgetary constraints is unable to make the lump sum payment of the additional costs. The preferred approach in such cases would be for the Institution to retain the option to elect from amongst the choices of direct payment of the compensation, increase in the User Charges, payment of a supplementary Unitary Payment, or extension to the Service Period when the Compensation Event occurs (see further discussion under Section 47.3).

47.2.3 If the PPP Agreement contains liquidated damages for late completion of the Works (see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*)), then the Private Party will also be relieved from liability for such liquidated damages for the period of delay caused by the Compensation Event. The Private Party should, of course, also be relieved of any other liability for the Institution's losses in respect of the Compensation Event. This should be taken into account in determining the consequences for the Institution of a Compensation Event.

47.2.4 The main advantages of the prescribed approach are firstly, simplicity and secondly, that funders should prefer it, since the debt cover ratios and internal rate of return on Equity can be preserved. This approach also means that the Institution has an incentive to manage its rights and

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obligations in the construction phase in a way that does not result in delay. The detail of how this approach should work in practice can be seen with reference to Section 47.3 (*Calculation of Compensation*), below.

47.2.5 If the Private Party is fully compensated for the delay, there is no need to extend the Expiry Date.

47.2.6 The Private Party must use reasonable endeavours to mitigate its losses and costs (for example, by rescheduling its Works programme or by redeploying staff). Such mitigation may result in there being no delay in the Service Commencement Date (although extra costs may result from the steps taken to mitigate).

47.3 Calculation of Compensation[298]

47.3.1 The User Charges may need to be adjusted if the Compensation Event concerned involves additional cost[299] or a time delay which has cost and/or loss of revenue implications (and the Institution is unable to make the lump sum payment or agree to pay a supplementary Unitary Payment). It is important that the PPP Agreement contains an appropriate method for dealing with any payment variations that arise as a result of a Compensation Event. The Parties may at Signature Date agree on a set of financial and other tests to be used for the purposes of calculating the compensation payable for possible categories of compensation. Any agreement reached in respect of the value of the compensation payable should be final and not subject to change if it later

[298] Payment of any compensation will be subject to the regulations regarding budgets (see Part H:37 (*Payment and Financial Matters: Payments*)).

[299] In terms of the Regulatory Instruments, material amendments or amendments that change the risk profile or value for money considerations will require the approval of the Approving Authority. The Institution must ensure, at the relevant time, that it obtains the requisite approvals.

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transpires that the costs associated with such Compensation Event are greater (or less) than the amount agreed to. This is equally applicable to costs arising as a result of Variations and/or Unforeseeable Conduct (see Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*)).

47.3.2 One common way of dealing with such events is to rely on the Financial Model to deal with the issue and for both Parties to use this to calculate how and when compensation should be paid. Typically this would require the Institution to agree that the debt service cover ratios and internal rate of return on Equity remain unchanged. While there is no objection in principle to the Parties referring to a Financial Model to calculate compensation payable for Compensation Events (and for that matter the effects of an Institution Variation or Unforeseeable Conduct (see Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*)) provided both Parties fully understand all of the Financial Model's various aspects, there are several principle problems that can arise in using a Financial Model:

47.3.2.1 the Financial Model may obscure the process being followed in reaching the answer, unless there is clarity on all sides on how the relevant formulae used in the model work. For example, if something has happened which was not originally modelled for and audited, there could be conflict arising on how to model it, which could impact on the calculation concerned;

47.3.2.2 if the Institution has access to the Financial Model in sufficient detail and to all of the internal costs, returns and other assumptions (to the level of detail required), then more information than is relevant simply to value the consequences of the event may have to

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be provided by the Private Party, which may not be acceptable to it (and, in addition, certain of the assumptions may need to be updated); and

47.3.2.3 the result of preserving the ratios and internal rate of return on Equity can be achieved in a number of different ways (see Section 47.3.5).

A simple approach is recommended since the aim of this Section 47.3 is to ensure fair compensation for a limited number of events calculable in a relatively straightforward manner. If the User Charges are to change, then financial advice is necessary.

47.3.3 The prescribed approach to Compensation Events that may lead to a change in the User Charges is as follows:

47.3.3.1 if the event concerned requires Capital Expenditure (whether before or during the Service Period), then in most cases, it will be more practicable to deal with this by means of a lump-sum reimbursement (subject to the possibility of interim payments[300]); and

47.3.3.2 if the event concerned requires a change in operating costs, then an adjustment in the User Charges is the appropriate means of payment, unless the Institution is in a position to agree to a supplementary Unitary Payment.

In the event of an Institution breach it is also acceptable for the Institution simply to reimburse the Private Party on the basis of actual

[300] Significant Institution Variations are likely to be acceptable to the Private Party only if compensation is paid by the Institution so as to match the timing of the agreed costs of the Variation.

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costs incurred (for example, as a result of any delay in giving an approval).[301]

47.3.4 The approach of a lump-sum reimbursement and/or adjustment of the User Charges ensures that a minimum of additional financing costs is incurred. Other reasons, including affordability constraints, may, however, mean that the Institution wishes to reserve the right to ask the Private Party to use reasonable endeavours to finance the event where Capital Expenditure is required. If this is done, then careful scrutiny of the value for money implications should be undertaken.

47.3.5 Where the compensation involves an increased obligation to incur Capital Expenditure, other possibilities[302] include:

47.3.5.1 a lump-sum payment from the Institution paid immediately on Service Commencement. The amount of the lump-sum should exceed the amount of the relevant increase in Capital Expenditure by any incremental increase in financing costs as a result of a more frequent drawdown of Debt than originally anticipated and the agreed costs incurred in arranging any such financing;

47.3.5.2 an adjustment to the User Charges to take account of the Private Party's increased debt service obligations as a result of funding the event concerned. This adjustment would be appropriate to the actual terms and conditions of the funding, which would have been known to and approved by the Institution, and be applied on the basis that the funders are no worse and no better off, from the

[301] Where the Private Party is compensated from User Charges, an adjustment of the User Charges may entail time lag where the setting of tariffs is a regulatory function, and there are no upfront commitments by the regulatory body..

[302] Particularly to avoid the time and expense of engaging advisors for what may be minor compensation sums (if this approach is used), it is recommended that the Parties agree and record in the PPP Agreement the incremental impact on the User Charges of minor Capital Expenditure and operational expenditure changes.

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perspective of risk and return, than they would have been had the increase in Capital Expenditure not arisen. As stated above, in practice this generally means that an increase is made to the User Charges (over the term of amortisation of the additional dedicated funding) to restore the debt service cover ratios and the return on Equity to their values had the additional funding not been required. This calculation can only be made by using the Financial Model. ; or

47.3.5.3 particularly if the Institution cannot afford to pay compensation in the form of a lump-sum but wishes to avoid increasing the User Charges, it may offer to pay a supplementary Unitary Payment over a stipulated period in the form of an annuity equivalent of the Capital Expenditure. If this approach is adopted, the discussion can be reduced to a single issue, namely, the annuity rate to be applied. . As this supplementary payment is not dependent on the Project performance, an appropriate rate would be that applicable to instalment payments by the Institution of any compensation on termination.

47.3.6 If the event concerned involves a Capital Expenditure reduction (for example, cancellation of a wing of a building), it may not be possible to reduce the Unitary Payment as this is unlikely to be acceptable to the Shareholders, unless the internal rate of return on Equity remains unchanged (including, with reference to any cancellation fees payable in respect of Debt not drawn down or on account of prepayment penalties for drawn down Debt.

47.3.7 If the compensation arises only because of a change in operating costs then appropriate changes to the User Charges should be by negotiation

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between the Parties[303]. The change in the User Charges should be made at the time of the Compensation Event so as to reflect forecast operating costs changes, as to amount and timing. The use of lump-sum compensation payments or annuity equivalents is also inappropriate for changes in operating costs. As many of the above issues have complicated financial consequences, financial advisors should be consulted as to the most appropriate approach for a particular project.

47.3.8 In any event (even if this approach is taken in relation to Variations and Unforeseeable Conduct), it is not appropriate in any circumstances for a breach by the Institution of its obligations to give rise to an obligation on the Private Party to finance any Capital Expenditure consequences.[304]

47.3.9 In assessing the consequences of a Compensation Event, other causes of delays to the Service Commencement Date will be relevant as to whether the Private Party will receive relief from its obligations and/or compensation. The Private Party's losses should be calculated as accurately as possible at the time and appropriate payment made.

Standard Clause

Consequences of a Compensation Event

(a) If, as a direct result of the occurrence of a Compensation Event:[305]

(i) the Private Party is unable to achieve Service Commencement on or before the Scheduled Service Commencement Date;

(ii) the Private Party is unable to comply with its obligations under this PPP Agreement; and/or

[303] Other than where the tariff setting is a regulatory function performed by a sector-specific regulator.

[304] See Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*).

[305] In the event of a delay to the Scheduled Service Commencement Date, the construction costs will most likely increase due to a longer financing period. The Private Party is under a duty to mitigate its other costs associated with any delay (for example, by delaying recruitment, if this can be done).

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(iii) the Private Party incurs costs or loses revenue,[306]

then the Private Party is entitled to apply for relief from its obligations and/or claim compensation under this PPP Agreement.

(b) To obtain relief and/or claim compensation the Private Party must:

(i) as soon as practicable, and in any event within [x] days after it became aware that the Compensation Event has caused or is likely to cause delay, breach of an obligation under this PPP Agreement and/or the Private Party to incur costs or lose revenue, give to the Institution a notice of its claim for an extension of time for Service Commencement, payment of compensation and/or relief from its obligations under this PPP Agreement;

(ii) within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details[307] of the Compensation Event and the extension of time and/or any estimated change in project costs claimed;[308] and

(iii) demonstrate to the reasonable satisfaction of the Institution that:

(aa) the Compensation Event was the direct cause of the estimated change in project costs and/or any delay in the achievement of the Scheduled Service Commencement Date; and

(bb) the estimated change in project costs, time lost, and/or relief from the obligations under the PPP Agreement claimed, could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice.

(c) In the event that the Private Party has complied with its obligations under Clause (b) above, then:

(i) the Scheduled Service Commencement Date shall be postponed by such time as shall be reasonable for such a

[306] This loss means not only out-of-pocket costs but also a claim for loss of profits (including a lost completion bonus), if any, caused directly by the Compensation Event.

[307] The Institution and the Private Party may wish to specify in the PPP Agreement precisely what details are required.

[308] This figure will not calculate the compensation payable, but it gives an indication of the seriousness of the breach and so indicates what steps should be taken by way of mitigation.

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Compensation Event, taking into account the likely effect of delay;[309]and

(ii) in the case of an additional cost being incurred by the Private Party:

(aa) on or before the Service Commencement Date; or

(bb) as a result of Capital Expenditure being incurred by the Private Party at any time,

the Institution shall within [x] days after being notified of the Compensation Event supported by all relevant information under Clause (b), make its election from one of the following options:

(A) to compensate the Private Party for the actual estimated change in project costs as adjusted to reflect the actual costs reasonably incurred within [x] days of its receipt of a written demand by the Private Party[310];

(B) to agree to an appropriate adjustment to the User Charges (subject to any required Consents from a Responsible Authority);

(C) to agree to a Unitary Payment over the Service Period calculated on the basis of an annuity rate applied to the actual costs reasonably incurred by the Private Party; or

(D) to increase the Service Period by a period that, taking into account the assumptions in the Financial Model, maintains the [internal rate of return on Equity];

provided, in the event the required Consent of the Responsible Authority for an adjustment to the User Charges under Clause (c)(bb)(B) is not provided within [x] days of an application made therefor, the Institution shall make its election from amongst the remaining options set forth above.

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[309] This is only necessary if there is a Long Stop Date. If the Private Party is required to pay the Institution liquidated damages for failure to achieve Service Commencement by the Scheduled Service Commencement Date, the Institution should consider how the Private Party's obligation to pay will be relieved if a Compensation Event occurs after the Scheduled Service Commencement Date but prior to actual Service Commencement.

[310] This payment can be in the form of monthly payments as expenditure is incurred (or staged payments against milestones) and invoiced if the delay is for a significant period of time.

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(iii) in the case of a payment of compensation for the estimated change in project costs that does not result in Capital Expenditure being incurred by the Private Party but which reflects a change in the costs being incurred by the Private Party after the Service Commencement Date, the Institution shall compensate the Private Party in accordance with Clause (f) below by electing from one of the options set forth in sub-clauses (B), (C) and (D) of Clause (c)(bb) above; and /or

(iv) the Institution shall give the Private Party such relief from its obligations under this PPP Agreement, as is reasonable for such a Compensation Event.

(d) In the event that information is provided after the dates referred to in Clause (b) above, then the Private Party shall not be entitled to any extension of time, compensation, or relief from its obligations under this PPP Agreement in respect of the period for which the information is delayed.

(e) If the Parties cannot agree on the extent of any compensation, delay incurred, or relief from the Private Party's obligations under this PPP Agreement, or the Institution disagrees that a Compensation Event has occurred (or as to its consequences), or that the Private Party is entitled to any relief under this Clause, the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).

(f) Any payment of compensation referred to in Section (c) (iii) above shall be calculated in accordance with [Clause [x] (Calculation of Compensation) above].[311]

48 FORCE MAJEURE

48.1 Introduction

48.1.1 Relief Events include several events which have often been included in the definition of Force Majeure. As the remedies available under Relief Events deal adequately with the consequences of such events, there is no need for the all-encompassing definition of Force Majeure that has been common in many contracts concluded to date. Force Majeure should be

[311] The Institution should not agree to a provision whereby, after the relevant effects of the Compensation Event have been calculated, there is an adjustment of the compensation if the costs are greater or lesser than those agreed or estimated.

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defined to include those very limited events which are out of the control of both Parties and which, if they continue for a certain period of time,[312] can result in termination of the PPP Agreement. Force Majeure should only include those events that are likely to have a material adverse consequence on either Party's[313] ability to fulfil its obligations under the PPP Agreement and which are uninsurable. As events of Force Majeure are usually highly unlikely events that are beyond the control of both Parties with neither Party being in any better position to bear such risk, the consequences of an event of Force Majeure should be shared between the Parties.

48.1.2 The Party claiming the occurrence of an event of Force Majeure is only excused from performance to the extent that it is unable to comply with all or a material portion of its obligations under the PPP Agreement. Either Party may terminate the PPP Agreement as a result of an event of Force Majeure, only if the Parties are unable, within the specified period, to agree on how best to continue the Project in light of the Force Majeure event (See Part N:61 (*Termination: Compensation on Termination for Force Majeure*)).

48.1.3 For so long as the event of Force Majeure continues, the Private Party should be entitled to charge and bill for Services actually made available by the Private Party, taking into account any reduction in the Private Party's operating costs due to the Force Majeure event preventing substantial performance. The Private Party should not be entitled to any amount simply to ensure that it is in a position to meet its debt service obligations in whole or in part as its debt service reserve account should cover this.

[312] Usually six months, but this may vary depending on the particular project.

[313] Usually the Private Party's.

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48.2 Consequences of Force Majeure

48.2.1 When either Party claims the occurrence of an event of Force Majeure, the Parties should meet in order to find a mutually acceptable solution for the continuation of the Project. Such solution may include the following:

48.2.1.1 the reinstatement of the Facilities, although neither Party would be obliged to do this;

48.2.1.2 adjustment of the Services requirements and/or output specifications;

48.2.1.3 amending the payment mechanism; and/or

48.2.1.4 the extension of the Project Term.

48.2.2 The solution will depend on the nature of the event and its effects on the particular Project.

48.2.3 If the Parties cannot agree on a solution within the stipulated period, either Party should be entitled to terminate the PPP Agreement with compensation payable to the Private Party as set out in Part N: 61 (*Termination: Compensation on Termination for Force Majeure*).

Standard Definition

*"**Force Majeure**" means any of the following events to the extent that they are uninsurable:*

(a) war, civil war, armed conflicts or terrorism; or

(b) nuclear contamination unless the Private Party and/or any Subcontractor is the source or cause of the contamination; or

(c) chemical or biological contamination of the Works and/or the Facilities and/or the Project Site from any of the events referred to in Clause (i) above,

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which directly causes either Party to be unable to comply with all or a material part of its obligations under this PPP Agreement.

Standard Clause

Force Majeure

(a) Subject to Clauses (b)(ii) and (iii) the Party claiming relief shall be relieved from liability under this PPP Agreement to the extent that by reason of the Force Majeure event it is not able to perform all or a material part of its obligations under this PPP Agreement.

(b) Where a Party is (or claims to be) affected by an event of Force Majeure:

(i) it shall take all reasonable steps to mitigate the consequences of such an event upon the performance of its obligations under this PPP Agreement, resume performance of its obligations affected by the event of Force Majeure as soon as practicable and use all reasonable endeavours to remedy its failure to perform; and

(ii) it shall not be relieved from liability under this PPP Agreement to the extent that it is not able to perform, or has not in fact performed, its obligations under this PPP Agreement due to its failure to comply with its obligations under sub-Clause (b)(i).

(c) The Party claiming relief shall serve written notice on the other Party within [x][314] Business Days of it becoming aware of the relevant event of Force Majeure. Such initial notice shall give sufficient details to identify the particular event claimed to be an event of Force Majeure.

(d) A subsequent written notice shall be served by the Party claiming relief on the other Party within a further [x] Business Days which shall contain such relevant information relating to the failure to perform (or delay in performing) as is available, including (without limitation) the effect of the event of Force Majeure on the ability of the Party to perform, the action being taken in accordance with Clause (b)(i), the date of the occurrence of the event of Force Majeure and an estimate of the period of time required to overcome it (and/or its effects).

[314] In IT projects "immediate" notice is usually required.

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(e) The Party claiming relief shall notify the other as soon as the consequences of the event of Force Majeure have ceased and when performance of its affected obligations can be resumed.

(f) If, following the issue of any notice referred to in Clause (d), the Party claiming relief receives or becomes aware of any further information relating to the event of Force Majeure (and/or any failure to perform), it shall submit such further information to the other Party as soon as reasonably possible.

(g) During the continuance of any event of Force Majeure which occurs on or after the Service Commencement Date the User Charges payable in respect of such period shall be reduced to an amount equivalent to the User Charges payable in respect of those Services that are available during such period after taking account of the effects of such event of Force Majeure.

(h) If an event of Force Majeure occurs before the Service Commencement Date, the Private Party shall not be entitled to receive any payment in respect of the User Charges.

(i) Subject to Clause [x][315] the Private Party's sole right to payment or otherwise in relation to the occurrence of an event of Force Majeure shall be as provided in this Clause.

(j) The Parties shall endeavour to agree any modifications to this PPP Agreement which may be equitable having regard to the nature of an event or events of Force Majeure. Clause [x] (Fast-track Dispute Resolution) shall not apply to a failure of the Institution and the Private Party to reach agreement pursuant to this sub-Clause.

[315] The Clause providing for compensation on termination for Force Majeure. See Part N: 61 (*Termination: Compensation on Termination for Force Majeure*).

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PART K: UNFORESEEABLE DISCRIMINATORY GOVERNMENT CONDUCT AND VARIATIONS

49 UNFORESEEABLE DISCRIMINATORY GOVERNMENT CONDUCT

49.1 Introduction

49.1.1 The Private Party is obliged under the PPP Agreement to comply with all applicable law. A failure to comply could give rise to termination for Private Party Default (see Part N:55 (*Termination: Causes of Termination*)). The cost of complying with law that is current or foreseen at the Signature Date is usually built into the price which the Private Party bids in order to provide the Services. It may, however, not be possible for the Private Party to price specific costs that may arise from changes in law which are not foreseen at the Signature Date. The issue then is who should be responsible for the costs arising from changes in law and how such costs should be funded.

49.1.2 In addition, Private Parties often also seek relief from the consequences of any actions or omissions by Responsible Authorities that do not constitute changes in law but which may affect the return on Equity, debt service or otherwise result in any increase in costs to the Private Party. Private Parties argue that they submit bids on the basis that they will not be materially adversely affected by such unforeseeable discriminatory conduct on the part of government, whether as a result of a change in law or any act or omission by any Responsible Authority. However, this presumption is usually misplaced.

49.1.3 In this Standardisation, "Unforeseeable Conduct" refers to both changes in law including statutes, regulations and by-laws as well as any act or omission by any Responsible Authority and the Institution to the extent

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that such act or omission is not covered by the other terms of the PPP Agreement.

49.2 Private Party's and Institution's Concerns

The Private Party's concern is that Unforeseeable Conduct is a risk which it cannot control and which it regards as being within the control of the Institution or wider government. Under its contracts with other private sector parties, the Private Party is usually able to pass on the costs of Unforeseeable Conduct to its customers through an increase in price or, in contracts of relatively short duration, is able to take a view on the prospects of Unforeseeable Conduct arising during the term of the contract. As the prices in PPPs are agreed on a long-term basis and are not flexible in the same way, the Private Party may believe that it should not have to bear the costs of Unforeseeable Conduct. In practice, however, many Institutions exert negligible, if any, influence over Unforeseeable Conduct by wider government. Furthermore, the private sector has in all other contexts successfully managed to absorb the effects of such Unforeseeable Conduct and minimise the full effect of price changes to its customers. In addition, there is no reason why Private Parties should be in any better position regarding the consequences of Unforeseeable Conduct than their counterparts in non-PPP endeavours, except where the Unforeseeable Conduct discriminates against them because they are engaged in a PPP. The Institution must not reduce the Private Party's incentive to manage its costs even where it agrees to meet the Private Party's costs resulting from Unforeseeable Conduct.

49.3 Allocation of Risk of Unforeseeable Conduct

49.3.1 In some projects, it is possible to treat Unforeseeable Conduct of any type as being at the Private Party's risk, particularly in projects in which such costs can be passed on to the users of the project. It is, however, not

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always possible to pass this increase in costs on to the users, especially where the user tariff is one set by the Institution or a Responsible Authority not a party to the PPP Agreement (see Part J: (*Relief Events, Compensation Events and Force Majeure*)). In instances where the risks cannot be quantified or passed on to third party users – and in User Pay PPPs the rebuttable presumption should be that it cannot – a risk sharing approach should be developed.

49.3.2 The risk of Unforeseeable Conduct that is of a general nature in that it does not discriminate against the Private Party should be borne by the Private Party. Unforeseeable Conduct that discriminates against the Private Party, either as an individual entity[316] or more likely as a member of a specific group of entities (for example all private parties in PPP Agreements) should generally be the Institution's risk.

49.3.3 In addition to the Unforeseeable Conduct having to be discriminatory in order for the Institution to compensate the Private Party, the Unforeseeable Conduct which the Private Party complains of must not only have been unforeseeable by a reasonable person in the position of the Private Party at the Signature Date, it must also have in fact been unforeseen by the Private Party at such date. If the conduct was actually foreseen by the Private Party or ought reasonably to have been foreseen (that is, was foreseeable) by the Private Party, it will not constitute Unforeseeable Conduct. Accordingly, the Private Party should bear the risk in relation to that conduct and the Institution should not compensate the Private Party for any loss.

[316] This is unlikely in the case of a change in law because laws do not usually refer to individual entities or persons, but rather to groups with specific characteristics.

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49.3.4 To the extent that any conduct is specifically dealt with elsewhere in the PPP Agreement, such conduct should not constitute Unforeseeable Conduct and the Private Party should not be entitled to any relief pursuant to the Unforeseeable Conduct provisions.

49.4 Mitigation

49.4.1 Whenever the Institution bears some of the risk of Unforeseeable Conduct, the Private Party must be obliged to use all reasonable endeavours to mitigate any cost increases. This duty to mitigate should also require the Private Party to foresee and anticipate the effect of any Unforeseeable Conduct, particularly in relation to planned expenditure that is in the ordinary course of business.

49.4.2 In the event that the Parties agree or it is determined pursuant to dispute resolution procedures that any Unforeseeable Conduct has occurred, the Private Party should be entitled to relief from the Institution. The Institution should be entitled to decide how best to compensate the Private Party for its losses provided that the compensation puts the Private Party in the same overall economic position it would have been in had the Unforeseeable Conduct not occurred.

Standard Definition

*"**Unforeseeable Conduct**" shall occur if, after the Signature Date, the Institution or any Responsible Authority takes any action (including the introduction, application, or change of any law, regulation, by-law or order having the force of law) or fails to carry out its obligations as prescribed by law; and*

(a) the principal effect of which is directly borne by:

(i) the Project and not other similar PPPs;

(ii) the Private Party and not other persons; or

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(iii) parties undertaking PPPs and not other persons;

(b) in respect of which the Private Party is not entitled to any other relief pursuant to any other provisions of this PPP Agreement;

(c) which was not foreseen by the Private Party on or before the Signature Date; and

(d) which could not reasonably have been foreseen by any person in the position of the Private Party on or before the Signature Date;

provided that:

(aa) Unforeseeable Conduct shall be deemed not to have occurred under circumstances where any action or omission of the Institution or Responsible Authority is in direct response to any act or omission of the Private Party which is illegal (other than an act or omission rendered illegal by virtue of such conduct of the Institution or Responsible Authority) or in violation of agreements to which the Private Party is a party;

(bb) an increase in taxes of general application which does not discriminate against the Private Party or against the Private Party and other parties undertaking PPPs shall be deemed not to be Unforeseeable Conduct; and

(cc) Unforeseeable Conduct shall be deemed not to have occurred if such conduct by the Institution or any Responsible Authority is required as a result of an event of Force Majeure and is reasonably proportionate thereto.

Standard Clause

Unforeseeable Conduct

(a) Should any Unforeseeable Conduct occur which materially and adversely affects the general economic position of the Private Party, the Private Party shall be entitled to such compensation and/or relief from the Institution as shall place the Private Party in the same overall economic position as the Private Party would have been in but for such Unforeseeable Conduct.

(b) Should any Unforeseeable Conduct occur which materially beneficially affects the general economic position of the Private Party, the User Charges shall be adjusted so that the Private Party remains in the same overall economic position it would have been in had the materially beneficial Unforeseeable Conduct not occurred.

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(c) The Party claiming the occurrence of the Unforeseeable Conduct ("Claiming Party") shall give written notice to the other Party ("Receiving Party") containing reasonable particulars of such conduct and its likely economic consequences to the Private Party.

(d) The Receiving Party shall have 60 (sixty) days from the date of receipt of such notice to effect a remedy for the Unforeseeable Conduct which restores the general economic position of the Private Party to that which it would have been in if such Unforeseeable Conduct had not occurred. If the Receiving Party does not effect such a remedy within such period, the Parties shall consult within 10 (ten) Business Days after the expiration of such period with a view to reaching a mutually satisfactory resolution of the situation. In the event that a mutually satisfactory resolution has not been reached within such 10 (ten) Business Day consultation period, the matter shall be dealt with in accordance with Clause [x].[317]

(e) In so far as the Private Party is the Claiming Party, it shall use all reasonable endeavours to minimise and mitigate the effects of any Unforeseeable Conduct.

50 VARIATIONS

50.1 Introduction

50.1.1 The output specifications, which are set out in the PPP Agreement, should take into account the Institution's current as well as its future requirements to the extent that these are identifiable and quantifiable.

50.1.2 Variations to the output specifications may, however, be necessary to cater for changes in the Institution's requirements which could not be anticipated or quantified at Signature Date or changes imposed by external factors for which the Institution has retained responsibility (for example, a change of policy). The Approval Authority must be notified of all Variations prior to their implementation. Variations which impact

[317] This should refer to the ordinary dispute resolution provisions.

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on affordability and/or result in an increase in the User Charges will require a new approval.

50.1.3 The Private Party may also wish to propose Variations either to the output specifications themselves or to the way in which it delivers the Services. Although the output specifications should not prescribe the method of delivery of the Services, there may be circumstances where aspects of the method of delivery impact on the Services requirements and are therefore critically important to the Institution. In such circumstances, the Institution will wish to be consulted formally prior to the implementation of the changes.

50.1.4 The key issue regarding Variations proposed by either Party is whether such Variations are mandatory and how the cost (if any) of implementing such Variations is to be allocated. The PPP Agreement should therefore contain a mechanism by which Variations may be proposed by either Party and evaluated and approved prior to implementation.

50.2 Factors to Consider

50.2.1 A proposed Variation may involve changes to the Works and/or the Services. Depending on the nature of the Variation, costs may be incurred in implementing such Variation, which were not originally anticipated. Changes to the Services that involve additional capital or operating costs are generally not priced for by the Private Party. Both the Private Party and its funders may be concerned that Variations will have an adverse impact on the Project's economics. The Private Party should not be required to increase its contingency funding supply to cover possible Institution Variations as this may not provide value for money especially where the Variation is not necessary.

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50.2.2 While the PPP Agreement must cater for the flexibility required to meet major Variations in the Institution's operating environment, such changes should be minimised where possible as they are likely to involve lengthy and possibly costly negotiations with the Private Party and its funders.

50.2.3 Variations that result in the Private Party's risk profile being adversely affected are unlikely to be acceptable to the Private Party. If it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that any Variation will adversely affect the Private Party's risk profile, the Private Party should be entitled to veto such Variation without the Institution having recourse to the fast-track dispute resolution procedure.

50.2.4 Some Variations may, of course, involve no additional costs and may even reduce certain costs. The Parties will then need to agree upon the best way to pass through such savings to the Institution (in the case of an Institution Variation) or to end users, or to share such savings (in the case of a Private Party Variation). Where Variations involve a decrease in the scope of the Services this may not be implemented unless the re-pricing of the Project or the Services is conducted in accordance with The remainder of this Part assumes that Variations (whether generated by the Institution or the Private Party) will lead to additional costs being incurred.

50.3 Institution Variations

50.3.1 Institution Variations should be limited to changes to the Services requirements, the specified constraints on inputs and the limits or scope

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of the Project Insurances.[318] The form of the Variation should be a restatement of the original specification.

50.3.2 In some projects, Institution Variations may be quite foreseeable. In such circumstances, where the Institution's future requirements are reasonably well known, the Institution should consider the feasibility of requiring the Private Party to commit to pricing pre-specified Variations as part of the PPP Agreement (for example, unit prices and labour rates). It is however unlikely that the Institution will be able to foresee all Variations.

50.3.3 In all PPP Agreements, there is an inevitable tension between cost and flexibility. The cheapest User Charges may provide the Institution with the least flexibility in managing the PPP Agreement since the ability to absorb unforeseen changes and risks inevitably comes at a price. To preserve flexibility in managing the PPP Agreement, the Institution must carefully assess whether or not it requires pre-priced options to vary scope, pre-priced unit rates for additional capacity of service delivery, comprehensive rights to insist on benchmarking market costs, open book accounting and cost transparency linked to prescribed margins for pre-agreed risk profiles.

50.3.4 Institution Variations during the Works phase should, where possible, be kept to a minimum. In exceptional circumstances the Private Party may, however, be able to incorporate, relatively cheaply, such a Variation during the Works phase that would become very expensive once the Services have commenced. The PPP Agreement should incorporate provisions to reflect this possibility.

[318] See **Error! Reference source not found.** (*Insurance*).

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50.3.5 The recommended Institution Variation procedure for all Variations other than Small Works Variations[319] is set out below. Initially, the Institution should serve a notice setting out the intended Variation and require the Private Party to provide an estimate of the technical, financial, contractual and timetable implications of the change within, say, 21 days. The Private Party should by this stage have been entitled to set out any reasons why the Institution was not entitled to seek such a Variation (or whether and for what reason it resists such a Variation). The intention at this stage is for the Private Party to provide quickly an estimate of the implications of the change.

50.3.6 The Institution should recognise that the Private Party's funders, in particular, are unlikely to allow the Private Party to agree to any Variation that would increase project or financing risk, and, as such, the sponsors are unlikely to allow the Private Party to agree to any Variation that would reduce the rate of return. Such limits must be reasonable. The Private Party should, therefore, have a right to veto a Variation that would adversely affect its risk profile. If the Private Party is fully protected against the consequences of an Institution Variation and how it is to be paid for there should be no objection by its funders or sponsors.

50.3.7 In considering whether the Private Party's objections are reasonable, the Institution should take into account all relevant circumstances. For example, if it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that the Variation will adversely affect the Private Party's risk profile, the Private Party should have a right to veto such a Variation without the Institution having recourse to the fast-track dispute resolution procedure. It would

[319] See Section 50.5 (*Small Works Variations*).

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also be reasonable for the Private Party to object to an Institution Variation that would result in a change in the nature of the Project.

50.3.8 If it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that the Variation will adversely affect the risk profile of the Private Party the Institution should not be entitled to proceed with the Variation.

50.3.9 If the Variation does not adversely affect the risk profile of the Private Party and the Institution still wishes to proceed with the Variation, the Private Party and the Institution should meet to discuss its implications. If the Variation is sufficient to require the Private Party to seek additional funding, this may not be secured until after the Institution has committed fully to implementing the Variation. It is therefore necessary to seek "reasonable endeavours" commitments for the Private Party to put the funding in place. If the Private Party is unable to put the funding in place, the Institution should reserve the right to fund the Variation through another method (for example, by providing the necessary funding itself). The Institution must ensure that the funding provided represents value for money.

50.3.10 The estimates and quotations should be a fair estimate of the likely implications of the Variation. Nevertheless, the Institution should ensure that it is paying a reasonable price to implement the Variation by including provisions within the PPP Agreement that:

50.3.10.1 make clear the duty of the Private Party to mitigate the costs;

50.3.10.2 ensure that there is transparency of information on costings;

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50.3.10.3 where the Variation is to be implemented by a Subcontractor, provide where possible for competitive quotes to be obtained; and

50.3.10.4 where the Variation is to be implemented by the Private Party, provide for the cost to be benchmarked against prevailing market rates.

50.3.11 If the Institution decides not to proceed with the Variation then this may have given rise to the Private Party incurring costs in estimating the cost of the Institution Variation. On the other hand, the Private Party may, in practice, seek to resist changes by quoting unrealistically high prices. The Private Party should have no automatic right to recover all of its costs associated with pricing the Variation as many of them will be internal costs that are already factored into its overhead provisions. If reimbursement is to be made, it should only cover reasonable additional costs. The following factors are relevant in determining whether this is appropriate:

50.3.11.1 the steps that have been undertaken by the Private Party to produce a reasonable estimate, and steps that would have been taken if the Private Party was producing its estimate in a competitive context;

50.3.11.2 the extent to which the Institution has access to the cost elements of the estimate (that is, its component parts can be verified); and

50.3.11.3 the extent to which Variations are part of the original requirement (for example, with training and simulator projects where changes are inevitable, whereas in many accommodation projects they can often be avoided).

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50.4 Means of Payment

50.4.1 The Institution Variation may require Capital Expenditure that will have the effect of increasing the Private Party's financing costs (for example, due to further construction work to be performed in the construction phase). In that case, the Institution should meet such costs by payment of a lump-sum, staged payments or sums to pay for the reasonable costs of the Private Party as they are incurred (on presentation of invoices), unless the Private Party is able to fund the costs itself and amortise them through the period of the PPP Agreement through an increase in the User Charges in a way that is value for money.[320] The Private Party should not receive payment in full before it has fully implemented the necessary Variation.

50.4.2 Any increase in operating costs resulting from an Institution Variation may be met by an increase in User Charges or by a supplementary Unitary Payment. Again, the Parties should decide whether the increase is best paid in a lump-sum, by increases to the User Charges or by the Institution paying a supplementary Unitary Payment. Reference may be made in this context to the discussion in Section 47.3 (*Calculation of Compensation*), which is equally relevant here.

50.4.3 If the Variation will reduce the Private Party's costs (whether Capital Expenditure or operating costs), then an appropriate reduction should be made to the User Charges that will apply (taking into account the fact that the Private Party's financial position should neither be benefited nor prejudiced). In the case of lower Capital Expenditure, the effect will be to reduce the amount of committed funding required by the Private Party.

Standard Clause

[320] The discussion in Section 47.3 in relation to increase of User Charges on the occurrence of a Compensation Event is relevant here.

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Institution Variations[321]

(a) *The Institution has the right to propose Variations to the Project Deliverables in accordance with this Clause. The Institution shall not propose a Variation which [x].*[322] *If the Institution requires a Variation to the Project Deliverables, it must serve a notice on the Private Party detailing the requested Variation (an "**Institution Variation Proposal**").*

(b) *The Institution Variation Proposal shall:*

(i) *set out the Variation required in sufficient detail as to enable the Private Party to calculate and provide the estimated revised Project costs in accordance with Clause (c) below (the "**Estimate**");*

(ii) *require the Private Party to provide the Institution within [x] Business Days of receipt of the Institution Variation Proposal, with the Estimate.*

(c) *As soon as practicable and in any event within [x] Business Days after having received the Institution Variation Proposal, the Private Party shall, subject to Clause (h) deliver the Estimate to the Institution. The Estimate shall include the opinion of the Private Party on:* [323]

(i) *whether relief from compliance with its obligations is required, including the obligations of the Private Party to achieve the Scheduled Service Commencement Date and meet the [performance regime] during the implementation of the Variation:*

(ii) *any impact on the Scheduled Service Commencement Date;*

(iii) *any impact on the provision of the Services;*

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[321] The suggested approach is for (where possible) a lump-sum payment to be made for an Institution Variation with no obligation being imposed on the Private Party to seek additional funding. However, should the Institution desire to retain the options of an increase to User Charges or a Supplementary Unitary Payment for compensation for the Institution Variation, then the drafting changes in the Standard Clause (*Consequences of Compensation Events*) under Section 47.3 (*Calculation of Compensation*) should be included in this standard clause.

[322] Limits on the Institution's ability to request variations to the Project Deliverables may be appropriate in some circumstances. This will depend on the Project, but there will be a point at which what is proposed is no longer the same service (or incidental or ancillary to it) and the Institution should have no difficulty with the principle of limiting its ability to suggest changes in this way. Examples of appropriate limits include, in general terms: (i) Variations which require the Services to be performed in a way that infringes any law or is inconsistent with Good Industry Practice; (ii) Variations which would cause any Consent to be revoked (or be unobtainable); (iii) Variations which would, if implemented, result in a change in the nature of the Project (for example, as a prison or hospital); and (iv) Variations which would materially and adversely affect the Services in a way that is not compensated for.

[323] Other information may be needed depending on the Project.

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(iv) any amendment required to this PPP Agreement and/or any Project Document as a result of the Variation;

(v) any estimated revised Project costs[324] *that result directly from the Variation;*

(vi) any loss of revenue that will result directly from the Variation;

(vii) any Capital Expenditure that is required or no longer required as a result of the Variation;

(viii) any regulatory approvals which are required; and

(ix) the proposed method of certification of any Works or operational aspects of the Variations required by the Institution Variation Proposal if not covered by the procedures specified in Clause [x] [the Services Commencement Clause].

(d) As soon as practicable after the Institution receives the Estimate, the Parties shall discuss and agree the issues set out in the Estimate. The Private Party shall:

(i) provide evidence that it has used reasonable endeavours (including (where practicable) the use of competitive quotes) to oblige its Subcontractors to minimise any increase in costs and maximise any reduction in costs;

(ii) demonstrate how any Capital Expenditure to be incurred or avoided is being measured in a cost-effective manner; and

(iii) demonstrate that any expenditure that has been avoided, which was anticipated to be incurred to replace or maintain assets that have been affected by the Institution Variation concerned, has been taken into account in the amount which in its opinion has resulted or is required under Clauses (c) (iv) and/or (v) above.

In such discussions the Institution may modify the Institution Variation Proposal and (if the estimated increase in Capital

[324] This Estimate should take into account any previously budgeted capital costs which will no longer be incurred due to the Variation (for example, if a new type of roof is needed during the construction phase, that could potentially result in lower maintenance costs). The costs should also be broken down in accordance with a pre-agreed framework so that sufficient transparency exists (see Part J:46 (*Relief Events*), Part J:47 (*Compensation Events*) and Part J:48 (*Force Majeure*)).

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Expenditure in respect of the Variation is expected to exceed PKR[x] (indexed to [CPI]) and it is practicable for the Private Party to do so), the Institution may require the Private Party to seek and evaluate competitive tenders for the relevant capital works. In each case the Private Party shall, as soon as practicable, and in any event not more than [x] days after receipt of such modification, notify the Institution of any consequential changes to the Estimate.

(e) *The Private Party shall comply with Good Industry Practice with the objective of ensuring that it obtains best value for money (taking into account all relevant circumstances including, in particular, the requirement that the Private Party should not be worse off as a result of the implementation of the Variation) when procuring any work, supplies, materials or equipment required in relation to the Variation.*

(f) *If the Parties cannot agree on the contents of the Estimate, then the dispute will be determined in accordance with Clause [x] (Fast-track Dispute Resolution).*

(g) *As soon as practicable after the contents of the Estimate have been agreed or otherwise determined pursuant to Clause [x] (Fast-track Dispute Resolution), the Institution shall:*

(i) *confirm the Estimate (as modified) in writing; or*

(ii) *withdraw the Institution Variation Proposal.*

(h) *Notwithstanding the other provisions of this Clause [x]:*[325]

(i) *if, on receipt of the Institution Variation Proposal pursuant to Clause (a), the Private Party is of the opinion that such Variation is likely to result in an increase in the Project risk or its financial risk or to generally adversely affect the risk profile of the Private Party, it shall, as soon as practical and in any event within [x] Business Days after having received the Institution Variation Proposal, serve a notice on the Institution stating its opinion and the reasons therefor; and*

(ii) *the Parties shall meet as soon as practical and in any event within [x] Business Days of receipt of such notice. If the Parties agree that such Variation is likely to increase the Project risk or the Private Party's financial*

[325] This must refer to the entire clause.

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risk or to generally adversely affect the risk profile of the Private Party, the Institution Variation Proposal shall be withdrawn. If the Parties are unable to agree on the likely effects of the Institution Variation Proposal, either Party may refer the matter to [Independent Expert] pursuant to Clause [x] (Fast-track Dispute Resolution). If it is determined by [Independent Expert] that the Institution Variation Proposal will increase the Project risk, financial risk or generally adversely affect the risk profile of the Private Party, the Institution Variation Proposal shall be deemed to have been withdrawn.

(i) *If the Institution does not confirm the Estimate (as modified) in writing within [x] days of the contents of the Estimate having been agreed in accordance with Clause (d) or determined pursuant to Clause (f), then the Institution Variation Proposal shall be deemed to have been withdrawn.*

(j) *In the event that the Estimate (as modified) involves estimated Capital Expenditure*[326] *then the Private Party shall use its reasonable endeavours to obtain funding for the whole of the estimated Capital Expenditure, on terms reasonably satisfactory to it and the Institution.*

(k) *If the Private Party has used its reasonable endeavours to obtain funding for the whole of the estimated Capital Expenditure, but has been unable to obtain an offer of funding within [x] Business Days of the date that the Institution confirmed the Estimate, then the Private Party shall have no obligation to carry out the Variation, unless the Institution agrees to pay the costs involved.*

(l) *The Institution may, at any time following the date on which the Estimate is confirmed, agree to meet all or, to the extent the Private Party has obtained funding for only part of the Capital Expenditure, the remaining part of the Capital Expenditure.*

(m) *In the event that the Estimate has been confirmed by the Institution,*[327] *then the User Charges shall be adjusted in accordance with the Estimate.*[328]

[326] It may be appropriate to introduce a threshold on the estimated increased Capital Expenditure below which it is not necessary for the Private Party to seek to obtain funding. This should ensure that the Private Party is not required to go through the effort of arranging funding for relatively immaterial sums. Any such threshold should, however, be increased annually in line with CPI.

[327] If the Institution Variation simply has a cost consequence (and no change is made either in the timetable for completion or increase in costs of operation), then it can be dealt with as a one-off payment without an adjustment to the User Charges or timetable.

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(n) Where the Institution agrees to pay the costs for which funding is not available pursuant to Clause (k) above:

(i) the Institution and Private Party shall agree:

(aa) a payment schedule in respect of the payment of such sum reflecting the amount and timing of the costs to be incurred by the Private Party in carrying out the Variation to the extent borne by the Institution; and

(bb) where payment for part of the Variation reflects the carrying out of, or specific progress towards, an element within the Variation, an objective means of providing evidence confirming that the part of the Variation corresponding to each occasion when payment is due under the payment schedule appears to have been duly carried out,

(such payment schedule and evidence to be determined by [Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution) in the event of the Institution and Private Party failing to agree as to its terms);

(ii) the Institution shall make payment to the Private Party within [x] Business Days of receipt by the Institution of Invoices presented in accordance with the agreed payment schedule (as the case may be, varied by agreement from time to time) accompanied by the relevant evidence (where applicable) that the relevant part of the Variation has been carried out; and

(iii) if payment is not made in accordance with sub-Clause (n)(ii) above, the Institution shall pay interest to the Private Party on the amount unpaid from the date [x] Business Days after receipt of the relevant Invoice until paid, at the Default Interest Rate.

[328] The adjustment to the User Charges would take account of any increased operational costs of the Private Party and any increased capital costs funded by the Private Party. Any increased capital costs funded by the Institution or loss of revenue caused by the Institution Variation may be paid to the Private Party by way of direct payments from the Institution, through an increase in the User Charges or through a supplementary Unitary Payment. To the extent that the Institution Variation will prevent the Private Party from making the Services available, the Private Party should be relieved from the accrual of Penalty Deductions.

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50.5 Small Works Variations

50.5.1 To facilitate efficient management of the PPP Agreement, reduce costs for both Parties and ensure continued delivery of the Services, the PPP Agreement should provide an efficient mechanism for dealing with requests by the Institution for small Variations to the Works. The small works procedure should only be used for the purposes of requiring additional capital works. Due to the complexity of requiring Variations to the Services element, the Private Party will not be able to provide the Institution with annual rates relating to such Variations, and such Variations will need to be requested in accordance with Section 50 (*Variations*).

50.5.2 In any PPP Agreement year the Institution may have to make several requests to the Private Party in respect of minor Variations to the Works. Provided that the threshold is sufficiently low for the Private Party to manage, there is no reason why the Private Party should not be able to provide a schedule of rates to the Institution at the beginning of each PPP Agreement year, which, (when agreed) shall apply in respect of all requests from the Institution for small Works Variations to be implemented by the Private Party. The Private Party should provide the Institution with a rate in respect of labour costs, while the materials element of any small Works Variations should be charged at cost plus a pre-agreed margin. The Institution should reimburse the Private Party for small Works Variations in accordance with these rates.

Standard Definition

*"**Small Works**" means any change[329] to the Works requested by the Institution having an individual cost not exceeding PKR[x] (indexed to*

[329] Small works are not intended to cover works that require specialist labour that the Private Party or its Subcontractors are unable to perform.

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[CPI]), or as otherwise agreed from time to time, except for any request which will (if implemented) increase the likelihood of the Services not complying with the [performance regime][330] or materially and adversely affect the Private Party's ability to perform its obligations under this PPP Agreement.

Standard Clause

Small Works Variations

*(a) At least [x] days prior to the Scheduled Service Commencement Date and the commencement of each subsequent PPP Agreement year, the Private Party shall propose a schedule of rates to be agreed with the Institution (the "**Small Works Rates**"), such agreed rates to be applied in respect of any request from the Institution for Small Works to be completed during that PPP Agreement year. The value of any Small Works shall be calculated on the basis that:*

(i) the labour element shall be calculated in accordance with the Small Works Rates or, where such rates are not applicable, in accordance with rates which are fair and reasonable; and

(ii) the materials element shall be charged at the cost of the materials to the Private Party or to the party carrying out the work (net of all discounts) plus [x]%.[331]

(b) The Institution shall pay the Private Party for the costs of Small Works Variations in accordance with the Small Works Rates.

(c) The Private Party and the Institution shall agree the timing of any Small Works, so as to minimise any inconvenience to the Institution. The Private Party shall take all reasonable steps to minimise the duration of any Small Works.

(d) Any dispute between the Parties relating to Small Works shall be determined by [Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution).

[330] This is the regime in terms of which Penalty Deductions are calculated.

[331] To be determined on a project-by-project basis.

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50.6 Private Party Variations

50.6.1 The Institution should generally not be concerned with the means by which the Services are made available and should not normally object to any Variation in such means. The Private Party should be encouraged to find ways of making the Services available more cheaply and efficiently.

50.6.2 It may, however, be appropriate for the Institution to reserve the right to object to certain Variations in the means of delivery.[332] In such cases, a procedure should be built into the PPP Agreement providing for the Private Party to serve a Private Party Variation Proposal (including any consequential amendments required to the PPP Agreement and other Project Documents) on the Institution, giving the Institution an opportunity to object on reasonable grounds within a reasonable time period. If the Institution objects, the Private Party Variation Proposal should not be made or should be amended and presented again.

50.6.3 In all PPP Agreements, however, the Institution will need a similar procedure to be followed if the Private Party proposes a Variation to the Services, although in this case the Institution should not be under any obligation to give reasons for any refusal to agree to a change.

50.6.4 The Institution should generally object only if the primary tenets of the PPP Agreement are likely to be compromised. This might be the case if:

50.6.4.1 the Variation will not provide the Institution with the Services it requires;

50.6.4.2 the Variation diminishes the quality of the Services to be delivered by the Private Party or the likelihood of successful delivery;

[332] This may be the case, for example, if the Private Party's proposed Variation will adversely affect the Institution's ability to perform any retained activities (such as clinical services in a hospital).

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50.6.4.3 the Variation will interfere with the Institution's relationship with third parties;

50.6.4.4 the Variation threatens the Private Party's financial robustness;

50.6.4.5 the residual value of the Project assets is likely to be materially reduced (see Section 57 (*Termination: Handback*)); or

50.6.4.6 the Variation materially affects the risks or costs to which the Institution is exposed.

50.6.5 A Private Party Variation Proposal will not normally be expected to result in an increase in the User Charges but should allow the same Services to be made available more cheaply (so improving the return on Equity of the Private Party); improved Services to be made available at the same price; or a combination of the two. If the Private Party's costs will be reduced by the Private Party Variation Proposal, a reduction in the User Charges can be agreed as part of the procedure. The benefits could be shared between the Parties by increasing the quality and/or scope of the Services.

Standard Clause

Private Party Variations

(a) If the Private Party wishes to introduce a Variation,[333] *it must serve a notice on the Institution providing details of such Variation (a "**Private Party Variation Proposal**").*

(b) The Private Party Variation Proposal must:

(i) set out the proposed Variation in sufficient detail to enable the Institution to evaluate it in full;

[333] It is likely that a Variation in the means of delivery will, for the purposes of the PPP Agreement, result in a Variation to the Services.

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(ii) specify the Private Party's reasons for the Private Party Variation Proposal;

(iii) request the Institution to consult with the Private Party with a view to deciding whether to agree to the Private Party Variation Proposal and, if so, what consequential changes the Institution requires as a result;

(iv) specify all implications of the Private Party Variation Proposal on this PPP Agreement and any of its terms;[334]

(v) indicate, in particular, whether a Variation to the User Charges is proposed (and, if so, give a detailed cost estimate of such proposed Variation); and

(vi) indicate if there are any dates by which a decision by the Institution is critical.

(c) The Institution shall evaluate the Private Party's Variation Proposal taking into account all relevant issues, including whether:

(i) a change in the User Charges will occur;

(ii) the Variation will affect the quality or successful delivery of the Services;

(iii) the Variation will interfere with the relationship of the Institution with third parties;

(iv) the financial strength of the Private Party is sufficient to perform the Variation;

(v) [the residual value of the Project Assets is reduced];[335] *and*

(vi) the Variation materially affects the risks or costs to which the Institution is exposed.

(d) As soon as practicable after receiving the Private Party Variation Proposal, the Parties shall meet and discuss the matters referred to in it. During their discussions the Institution may propose modifications or accept or reject the Private Party Variation Proposal.

[334] For example, the contractual, financial, operational and/or construction implications of the Variation in Services.

[335] This will be relevant in projects in which the Institution bears all or part of this risk.

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(e) If the Institution accepts the Private Party Variation Proposal (with or without modification), the Private Party shall begin to implement the relevant changes arising from the Variation within [x] Business Days of the Institution's acceptance.[336] *Within this period, the Parties shall consult and agree the remaining details as soon as practicable and shall enter into any documents to amend this PPP Agreement or any relevant Project Document, which are necessary to give effect to the Variation.*

(f) If the Institution rejects the Private Party Variation Proposal, it shall not be obliged to give its reasons for such a rejection.

(g) Unless the Institution's acceptance specifically agrees to an increase in the User Charges, there shall be no increase in the User Charges as a result of that accepted Variation.

(h) If the Private Party Variation Proposal causes or will cause the Private Party's costs or those of a Subcontractor to decrease, there shall be a decrease in the User Charges such that [x].[337]

[336] This means that all aspects of the Variation must be agreed prior to implementation, including the availability of funding where appropriate.

[337] A mechanism should be agreed to the effect that any savings are shared, having deducted from any savings the costs which the Private Party has incurred in implementing the Variation.

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PART L: EMPLOYMENT

51 EMPLOYEES

51.1 Transfers

51.1.1 If a PPP involves the transfer or partial transfer of the existing operations of an Institution, then the interests of the employees employed in those operations must be considered..

51.1.2 The employees of Institutions may fall in three broad categories: (a) Civil Servants, (b) Statutory Employees, or (c) Contract Employees. Each employment category has its own legal incidents of employment, including in relation to transfers, termination, severance, salaries, benefits, retirement, and the like. For any PPP Project whereby the transferee is envisaged to become the employer, its obligations in relation to inheriting the transferor's employment liabilities in respect of the transferring employees, including its liability for all unpaid salaries, wages and benefits that have accrued in the period up to the transfer require specific attention. .

51.1.3 In case of Contract Employees, the transfer will be governed by the terms of the employment contracts. A review of the relevant employment contracts should therefore be carried out at the feasibility study stage. Such review will include termination and transfer rights of the Institution as the employer, the liability for accrued benefits including any gratuity or provident fund schemes.

51.1.4 Civil Servants cannot be 'transferred' to a Private Party in the manner Contract Employees can. In limited cases, subject to the consent of the civil servant, the device of deputation may be used provided it is

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demonstrable that the Private Party is performing the Institution's functions. However, the Institution will retain all control over the employment, including payment of salaries, termination, disciplinary proceedings, benefits, and the like, and this may not be acceptable to the Private Party who carries the prime responsibility for acts or omissions of its employees for delivery of Project Deliverables. Accordingly, it is recommended in this Standardisation that, unless consented by the Private Party, the Civil Servants be excluded from amongst the personnel that will be transferred with the Institutional Function and the Institution Assets to the Private Party.

Statutory Employees are governed by the respective statutory employment rules[338]. In some cases, the rules may enable transfer of Statutory Employees to the Private Party. However, the Institution should bear in mind that the bidders are likely to levy a substantial premium for taking transfer of such employees. Bid prices will reflect the value of unpaid accrued pre-transfer liabilities in respect of salaries, wages and benefits. Furthermore, given that the value of certain benefits, particularly pension benefits, may be an actuarial (as opposed to actual) value, the bid prices may also reflect substantial contingencies to cover potential inaccuracies in the calculation of these values.

51.1.5 In most cases, the prior consent of each employee will be required for his/her transfer.

51.1.6 The Institution should commence consultations with affected employees (and their trade unions) regarding their proposed transfer well in advance of the procurement phase of the Project to establish who among them wish to transfer to the Private Party and to ensure a smooth transfer

[338] For example, Pakistan International Airlines Corporation, WAPDA, Railways, etc., have their respective employment rules.

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process. To assist employees in this process, the Institution should (at its cost) appoint independent financial and tax advisors to advise employees regarding the transfer. It is important to ensure that, where any pension benefits may be paid out to transferring employees on transfer, these employees have access to such financial and tax advisors.

51.2 Basic Transfer Principles

In a PPP involving the transfer of employees by the Institution, the following basic principles should be followed:

51.2.1 the Private Party must be substituted in the place of the Institution in respect of all contracts of employment relating to those employees;

51.2.2 the transfer does not interrupt any such employee's continuity of employment and his/her contract of employment continues with the Private Party as if with the Institution;

51.2.3 all unpaid salaries, wages and benefits (including accumulated leave, pension benefits, post-retirement medical aid benefits, and so forth) that have accrued in the pre-transfer period should be independently valued. This independent valuation should also extend to unpaid employee liabilities (such as study loans and housing loans) that have accrued in the pre-transfer period;

51.2.4 the Institution should indemnify the Private Party in respect of any claim by a transferring employee for unpaid accrued pre-transfer employment liabilities that have not been taken into account in the valuation, if such indemnity will provide better value for money. Any such indemnity

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should be subject to the limitations mentioned in Part C:9 (*General Obligations: Indemnities and Claims for Damages*);[339] and

51.2.5 as between the Private Party and the Institution:

51.2.5.1 the Institution should assume no liability in respect of any employment liabilities that will accrue in the post-transfer period; and

51.2.5.2 the Institution's liability in relation to the transferring employees should not exceed the unpaid employment liabilities that have accrued in the pre-transfer period.

51.3 Control of Employee Conduct

51.3.1 Subject to all applicable labour laws as amended from time to time, the Institution may reserve for itself the right to instruct the Private Party to take appropriate disciplinary action, or ensure that such action is taken, against employees of the Private Party if there are reasonable grounds for such action. This need for control applies both to the performance of the Private Party's employees and to any Subcontractors (and their employees).

51.3.2 Although it may appear undesirable for the Institution to have such control, there may be sound reasons for this, for example, public health, public safety or national security.

[339] The indemnity and particularly any limitations on it will be a heavily debated issue. The Private Party and its funders will not want to assume any liability for the benefits and rights of employees accrued in the pre-transfer period because these will usually be very substantial and sometimes difficult to quantify in light of the nature of the benefits enjoyed by public sector employees (which are generally not matched in the private sector). For example, many public sector employees are members of defined benefit pension schemes rather than defined contribution schemes (as in the private sector). Defined benefits accrue regardless of the performance of the fund.

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51.3.3 Because such controls will have cost implications, the Institution must disclose its control requirements in the RFP and they must be included in the PPP Agreement. The Private Party's employment policies will need to reflect the Institution's requirements which may entail that the Private Party consult with the employees on a broader basis.

Standard Clause

<u>Key Personnel and Removal of Personnel</u>

(a) The Private Party shall at all times ensure that sufficient suitable and appropriately qualified and experienced personnel will be employed (whether by the Private Party or its Subcontractors) to undertake the Project Deliverables and that such personnel shall be located in Pakistan. Without limiting the generality of the foregoing, the Private Party shall ensure that all key personnel positions are always filled as soon as reasonably possible.

(b) The Institution may require the Private Party to remove any employee or other personnel of the Private Party or any Subcontractor from the Project Site and the Private Party shall do so (provided such removal is permitted under applicable law) if in the reasonable opinion of the Institution such employee or personnel engages in any conduct which might reasonably result in a breach of any provision of this PPP Agreement or threaten public health, safety or security, and the Private Party shall as soon as reasonably possible replace such employee or personnel with suitable appropriately qualified and experienced replacements (provided such replacement is permitted under applicable law).

52 PENSION BENEFITS

52.1 To the extent employees of the Institution are to be transferred to the Private Party, the transferability of the accrued pre-transfer pension benefits from the pension funds of the old employer to the funds of the new employer assumes significant importance.

52.2 In the circumstances, each type of benefit to be transferred needs to be assessed in detail to ensure that the employees are placed in substantially the same position in terms of benefits pursuant to their employment with the

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Private Party. This is important since certain benefits offered by various Institutions may not be matched by benefits available in the private sector. Examples in this regard are particular "State-funded" benefits such as post-retirement medical aid benefits.

52.3 Institutions should also be aware that the rules governing some pension funds may not expressly cover the situation where employees are transferred and may effectively require that the transferring employees be treated as having been retrenched or otherwise dismissed, with the result that their accrued pension benefits must be paid out to them on transfer and may not be transferred from the old employer to the new employer.[340] The Private Party will usually expect the Institution to procure that these benefits are paid out by the pension funds in full on transfer.

52.4 In light of the above, Institutions must undertake a thorough review of the rules of their pension funds to establish whether or not accrued pre-transfer pension benefits may be transferred to the Private Party's retirement funds. The results of this review must be included in the feasibility study accompanying the Institution's application for approval to the Approval Authority.

52.5 If the review establishes that the pension fund rules may restrict or bring about unintended consequences for the transfer of the employees, then the Institution should engage with the trustees or administrators of the pension fund, the employees and their trade unions regarding appropriate amendments to the rules.[341]

[340] The rules of these types of funds typically also preclude the transferring employees from retaining their membership once the transfer becomes effective.

[341] Institutions should be aware that some transferring employees might prefer to be paid out on transfer. The risk here is that these employees may spend all their pension benefits well before retirement. This is partly why it is so essential for Institutions to ensure that employees have access to independent financial and tax advisors. See Section 51.1.6 above.

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53 TRAINING

53.1 The PPP Agreement must incorporate the Private Party's undertakings in its bid documents (as improved on in the negotiation phase) with regard to the ongoing training of employees, where this is regarded important for the Services as well as for handback of the Project to the Institution with a trained pool of staff.

53.2 The Private Party will also be required to undertake and ensure that, at all times, there is a sufficient number of staff employed and that the Project Deliverables are carried out with the requisite level of skill and experience. The obligation extends over periods of vacation, sickness and other absence and must provide for such training and supervision as is necessary to ensure that all employees, whether permanent or replacement employees, who are expected to use or operate any equipment, receive adequate and ongoing training to ensure that there is proper performance in terms of the PPP Agreement. A critical component of the training[342] is to ensure compliance with all health and safety rules, procedures and requirements in respect of the Project Assets.

54 PROJECT SITE SAFETY AND SECURITY

54.1 The Private Party should set up and maintain policies and procedures covering all matters relevant to the Project including, without limitation, discipline, grievance, equal opportunities and health and safety.

54.2 In circumstances where the Parties have shared access to the Project Site or Facilities (for example, a hospital project), the PPP Agreement should specifically retain for the Institution the right to refuse admittance to, or to remove from, the Facilities any person employed by the Private Party or any

[342] In IT projects information security training is also important.

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Subcontractor whose presence in the reasonable opinion of the Institution is likely to have a material adverse effect on the performance by the Institution of its statutory duties or poses a serious threat to the health or safety of others. A procedure needs to be agreed to give the Institution the requisite authority.

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PART M: ANCILLARY INCOME

(i) A User Pay PPP may have sources of revenue additional to the primary sources (referred to as 'Ancillary Income'). For instance, the sale of merchandise by third parties in service areas constructed by the Private Party in a toll road Project may generate commission revenues additional to the tolls which form the primary revenue source. In solid waste projects, sale of dry recyclables and compost, electricity generation and income from carbon credits can also generate additional revenues. Ancillary Income is not User Charges in the sense used in this Standardisation, in that it is a byproduct of the User Pay PPP Project and its delivery is not the main object in constructing and operating the Project.

(ii) Ancillary income in a User Pay PPP raises additional complexities at the procurement as also the operations stage of the Project. For instance, where the Ancillary Income has the potential to contribute to reduction of User Charges and is therefore incorporated in the Project, should adverse changes to the market demand or other assumptions resulting in erosion of the Ancillary Income require an increase of the User Charges to maintain the level of cash flows? The converse of this proposition is also relevant: should an upside in the market conditions increasing the Ancillary Income result in a reduction of the User Charges to maintain the base case return on Equity? The answers to these questions will vary according to the sector, the specific Project as well as the specific sources of Ancillary Income being considered.

(iii) The preferred approach is to convert the Ancillary Income into User Charges where the economic and financial analysis of the Project at the feasibility stage indicates a reasonable likelihood of such income being realized at a level that justifies the required capital and operational expenditure. In such case, the works and services related to the Ancillary Income should be subsumed within the overall description of Works and Services for the Project, and the Financial Model should account for the Ancillary Income as an additional stream of the User Charges. The distinction between Ancillary Income and

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User Charges in that case will disappear; however, the Reporting Mechanism should reflect the distinction.

(iv) Where the demand and revenue projections for the services generating the Ancillary Income are not robust enough, but the opportunity to earn Ancillary Income has the potential of generating increased interest by the bidders, the Institution may consider offering the additional 'concession' to undertake the related works and provide the services alongside the core Works and Services. In such case, the assumption of risk by the Institution should be minimal; in particular, Compensation Events and Compensation upon Termination should be excluded for the related activities and investments. However, as the opportunity to earn the Ancillary Income is a direct consequence of the Project being implemented, the Institution should realize some benefit out of the grant of such concession.

(v) Such benefit to the Institution may consist of a share in the profits generated by the Ancillary Income, a fixed concession fee, a combination thereof or some other benefit. Care must be taken that the benefit sought to be derived by the Institution does not deter the Private Party from undertaking the relevant works; this may be the case where the Institution demands a high share of the profits or a high concession fee. The Private Party will have little incentive to commit investment when a substantial part of the return goes to the Institution. The Institution's objectives in performance of the Institutional function will be well served if the services generating the Ancillary Income are provided to a satisfactory level. The Institution should also exercise caution that it is not overly prescriptive in negotiating and agreeing the output specifications for the services generating the Ancillary Income in that case (unless these have a direct bearing on the core Services; for example, the quality of service areas in a toll road Project will be fundamental to the users of that road).

(vi) A further option could be for the Institution to require that if the profits from Ancillary Income increase beyond specified threshold levels, and provided the return on Equity under the Financial Model from User Charges has been met

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for a specified period (that is, the revenue projections are realized), then the revenues above pre-agreed threshold levels may be used to reduce the User Charges or transferred to a reserve fund that may be utilized for specific purposes (e.g., to fund Institution Variations) or on the occurrence of specific events (e.g. Compensation Events or reinstatement of the Project upon the occurrence of an insured event where the insurance proceeds are insufficient for full reinstatement, or for Uninsurability Relief). The Financial Model in such case ought to provide for these contingencies. The argument that estimates of Ancillary Income should be excluded from the Financial Model for being an 'extraneous' source of revenue should be rejected; any uncertainties or risks in the realizable amount of the Ancillary Income should be reflected in the sensitivity analysis in the Financial Model rather than excluding the Ancillary Income altogether.

(vii) One further possibility may be that the demand projections for the Ancillary Income are robust enough in the estimation of the Institution, but the bidders are not prepared to assume the related market risk. The bidder may offer to make the required investment, subject to the condition that their returns from the User Charges in relation to the core Services – in relation to which alone they are prepared to assume the revenue risk – should be maintained whole by increase to the User Charges if the revenues from the Ancillary Income fall short of the estimate. If the Institution is reasonably certain of its projections for uptake of services generating the Ancillary Income, it may decided to agree to an increase to the User Charges if the Ancillary Income falls short of the values assigned in the Financial Model. However, in such case the Institution must demand claw-back through reduction of the User Charges in case of Ancillary Income exceeding the estimates. The PPP Agreement in such case should be flexible so as to afford both the Private Party and the Institution the benefit of changes in the revenues relating to Ancillary Income. Further, the Institution must have the right in that case to specify the output specifications in relation to the Ancillary Income and levy Availability Deductions or Performance Deductions. The use of such mechanisms should operate to avoid windfall gains from Ancillary Income accruing to the Private Party.

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(viii) Assumptions of Ancillary Income in the Financial Model will assist the Institution in conducting its analysis of value for money and affordability for the User Pay PPPs. However, care must be taken in that over estimates of Ancillary Income that prove to be over optimistic may adversely affect the long-term financial stability of the Private Party, that will in turn require bail-out measures with additional cost implications for the Institution; failure of bail-out measures will adversely impact the continued service delivery by the Project.

(ix) The Institution's advisers should pay particular attention to these matters and the PPP Agreement should provide for the agreed positions in express terms.

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PART N: TERMINATION

55 CAUSES OF TERMINATION

55.1 Introduction

55.1.1 A Project may be terminated prior to the Expiry Date for any one of the following reasons:

55.1.1.1 Institution Default;

55.1.1.2 Private Party Default;

55.1.1.3 Force Majeure; or

55.1.1.4 Corrupt Acts (see Section 55.5 (*Termination for Corrupt Acts*)).

55.1.2 The reasons listed above should be the only reasons for termination and the Institution should not be entitled to terminate the PPP Agreement for convenience even if it is of the view that it is better equipped to render the Services itself.

55.1.3 The PPP Agreement must deal with the consequences of all types of termination. Usually, irrespective of the reason for termination, the Project Assets are dealt with in the same way on termination (see Section 57 (*Handback*)). The major difference between the different types of termination is the level of compensation (if any), payable to the Private Party in such event.

55.2 Termination for Institution Default

55.2.1 The PPP Agreement should clearly stipulate the events that would constitute an Institution Default and which would entitle the Private Party

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to terminate the PPP Agreement. As certain breaches by the Institution constitute Compensation Events that would entitle the Private Party to compensation[343] (see Part J:47 (*Relief Events, Compensation Events and Force Majeure: Compensation Events*)), the Institution Default should be limited to those breaches by the Institution which render the contractual relationship between the Parties untenable or completely frustrate the Private Party's ability to perform its obligations under the PPP Agreement. The Institution should, however, ensure that the Private Party always has a remedy for a breach by the Institution of its obligations under the PPP Agreement. The more serious breaches that render continuation of the Project impossible should constitute events of default.

Standard Definition

*"**Institution Default**" means any one of the following events:*

(a) an expropriation of a material part of the Project Assets and/or shares of the Private Party[344] by the Institution or other Responsible Authority;

(b) a failure by the Institution to make payment of any amount or amounts that are due and payable by the Institution under this PPP Agreement (which amounts are not in dispute) which, either singly or in aggregate exceeds the sum of PKR (x)[345] (index linked) and such failure continues for [x]Business Days from receipt by the Institution of a notice of non-payment from the Private Party;[346]

(c) a breach by the Institution of its obligations under this PPP Agreement which substantially frustrates[347] or renders it

[343] The Private Party will not have a right to terminate in these circumstances.

[344] This may be extended to cover the assets and shares of the Construction Subcontractor and/or the Operations Subcontractor if such an expropriation or sequestration would prevent the Private Party from performing its obligations under the PPP Agreement.

[345] The amount to be inserted will depend on the particular project.

[346] This provision assumes that interest on late payment is provided for in the PPP Agreement (see Part H: (*Payment and Financial Matters*)).

[347] If it is possible to identify specific breaches by the Institution that would of necessity completely frustrate the Private Party's ability to comply with its obligations or render the Parties' contractual relationship untenable, this list could be expanded. Care

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impossible for the Private Party to perform its obligations under this PPP Agreement for a continuous period of [x] months; and[348]

(d) a breach by the Institution of its obligations in terms of Clause[x](Assignment).[349]

55.2.2 Beyond this, the circumstances in which the Private Party is permitted to terminate for Institution Default must be considered on a project-by-project basis. The Institution needs to examine the nature of its obligations during the PPP Agreement and should only extend the list of Institution Default events to include breaches of other obligations that will render the contractual relationship untenable or completely frustrate the Private Party's ability to deliver the Services.

55.2.3 Termination by the Private Party should be a last resort and it is important to ensure that there are no "hair-triggers" which could put the Institution at risk. There can be no question of reciprocity with Private Party Default since the obligations of the Institution are principally approval rights (and payment obligations in Hybrid PPPs) rather than detailed performance obligations or obligations which affect third party rights (such as those of the Private Party's funders). The Private Party should bear in mind that a failure by the Institution to comply with the provisions of the PPP Agreement before Service Commencement (for example, issuing approvals) and sometimes after that date can, in most cases, be adequately dealt with by way of a Compensation Event (see Part J:47 (*Relief Events, Compensation Events and Force Majeure: Compensation Events*)). In addition, any failure by the Institution to make any payments when due should give rise to interest on late payment

must be taken, however, to ensure that termination is a last resort and can only be chosen by the Private Party when the Institution's action or inaction has made it impossible for the Private Party to perform its obligations under the PPP Agreement.

348 The periods triggering Institution Default are subject to the further remedy periods.

349 See Part S: 78.1 (*Miscellaneous: Assignment*).

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(see Part H: (*Payment and Financial Matters*)) and so a reasonable grace period for non-payment should be built into the PPP Agreement. Neither of these should trigger termination.

Standard Clause

Termination for Institution Default

(a) *On the occurrence of an Institution Default, or within [x] days after the Private Party becomes aware of same, the Private Party may serve notice on the Institution of the occurrence (and specifying details) of such Institution Default. If the relevant Institution Default has not been remedied or rectified within [x][350] Business Days of such notice, the Private Party may serve a further notice on the Institution terminating this PPP Agreement (save for Clauses [x, y and z])[351] with immediate effect.*

(b) *The Private Party shall not exercise or purport to exercise any rights to terminate this PPP Agreement (or accept any repudiation of this PPP Agreement) except as expressly provided for herein.*

55.3 Termination for Private Party Default

55.3.1 The PPP Agreement must deal comprehensively with the possibility of early termination owing to Private Party Default. It must achieve a fair balance between the Institution's desire to be able to terminate for inadequate Services provision, even if caused by relatively minor defaults (a right which the Institutions have in conventional service contracts), and the Private Party's and its funders' interests in restricting termination to the severest of defaults when all other reasonable alternative options have been exhausted, including reasonable rectification opportunities and step-in rights pursuant to a Direct Agreement (see Part O: (*Step-in*)). It should be the Institution's last resort to exercise rights of termination.

[350] This will vary from project to project and must be sufficient to enable the Institution to remedy the default.

[351] This must refer to those Clauses that are to survive termination of the PPP Agreement, such as the Clause dealing with the effects of termination.

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55.3.2 The PPP Agreement should specify the events of Private Party Default that may lead to termination. As far as practicable, these should be objective, clear and provide for reasonable tolerances,[352] bearing in mind the undesirable consequences of a termination.

Standard Definition

*"**Private Party Default**"[353] means any of the following events or circumstances:*

(a) any arrangement, composition or compromise with or for the benefit of creditors (including any voluntary arrangement as defined in the Insolvency Act, 1920 or the Companies Ordinance, 1984) being entered into by or in relation to the Private Party;

(b) a liquidator, receiver, official assignee or the like taking possession of or being appointed over, or any receivership, judicial management, winding-up, execution or other process being levied or enforced (and not being discharged within [x] Business Days) upon, the whole or any material part of the assets of the Private Party (in any of these cases, where applicable, whether provisional or final, and whether voluntary or compulsory);

(c) the Private Party ceases to carry on business;

(d) a resolution being passed or an order being made for the administration, receivership , winding-up, liquidation or dissolution of the Private Party (in any of these cases, where applicable, whether provisional or final and whether voluntary or compulsory);

(e) the Private Party fails to complete the Works on or before the Long Stop Date;[354]

(f) the Private Party commits a breach of any of its material obligations under this PPP Agreement not covered by

[352] For example with Penalty Deductions accumulating, and only triggering termination when a specific threshold is reached.

[353] These may be expanded depending on the specifics of the Project.

[354] Regard being had to the severe consequences of failing to complete the Works by the Long Stop Date, it is essential that this date be realistic, taking into account the nature of the Project while still incentivising the Private Party to complete the Works timeously.

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sub-Clauses (a), (b), (c), (d), (e), (g), (h), (i), (j), (k), (l), (m), (n)or (o);

(g) *the Private Party abandons the Works (other than as a consequence of a breach by the Institution of its obligations under this PPP Agreement);*

(h) *the Private Party ceases to provide all or a substantial part of the Services in accordance with this PPP Agreement (other than as a consequence of a breach by the Institution of its obligations under this PPP Agreement);*

(i) *the Private Party fails to comply with any provision of Clause [x](Assignment), Clause [y][the Clause dealing with the replacement of the Subcontractors] and Clause [z] (Changes in Control)*[355]*;*

(j) *the accumulation of [x] or more Penalty Deductions in any year/quarter and/or failure of the Private Party to replenish the Performance Security to its full amount within [x] days when the balance amount remaining for draws thereon has fallen to less than twenty (20) percent of the original guaranteed amount;* [356]

(k) *the Private Party fails to pay any sum or sums due to the Institution under this PPP Agreement (which sums are not in dispute) which, either singly or in aggregate, exceed(s) PKR[x] (indexed to [CPI]) and such failure continues for [x]Business Days from receipt by the Private Party of a notice of non payment from the Institution;*

(l) *the Private Party fails to obtain and maintain any Project Insurances as required in terms of Clause [x] (Insurance*);

(m) *termination of the Financing Agreements as a result of any default or acceleration of any amounts under the Financing Agreements*;

(n) *any breach of any provision of this PPP Agreement has occurred more than once and:*

(i) *the Institution has given an initial warning notice to the Private Party describing that breach in reasonable detail and stating that if that breach persists or recurs then the*

[355] See Part 78.3 (*Miscellaneous: Changes in Shareholding and Control*).

[356] This assumes that the PPP Agreement has provisions for the allocation of Penalty Deductions in respect of defaults on the part of the Private Party that in and of themselves are not sufficient to constitute Private Party Default. This is a very useful way of dealing with persistent breaches or accumulated but unrelated breaches. (See Part F: (*Services*) and Part H: (*Payment and Financial Matters*)).

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Institution may take further steps to terminate this PPP Agreement; and

(ii) the Institution has issued a second and final warning notice following the persistence or recurrence of that breach in the period of [x] days after the initial warning notice, stating that if that breach persists or recurs within the period of [x] days after the final warning notice then the Institution may terminate this PPP Agreement on [x] days' notice to the Private Party;[357] *and*

(o) any breach of the refinancing provisions.

55.3.3 Termination should be subject to remedy procedures and the rights of the Lenders under their Direct Agreement with the Institution. Prior to exercising its right to terminate for Private Party Defaults that are capable of being remedied,[358] the Institution must serve a Pre-termination Notice[359] on the Lenders which will trigger certain rights under the Direct Agreement that the Lenders will be entitled to exercise prior to the Institution exercising its right to terminate the PPP Agreement (see Part O: (*Step-in*)). The PPP Agreement should provide a mechanism which allows the Private Party to remedy breaches that are capable of being remedied in order to avoid termination. However, not all breaches may be remediable, or give rise to remedy opportunities: for example failure to complete the Works by the Long Stop Date or insolvency.

[357] Appropriate time periods will have to be inserted. These will depend on the nature of the Project. Also, this persistent breach provision is meant to cover breaches that are not covered by the Payment Mechanism at all or alternatively where the payment mechanism does not have a ratchet mechanism to cater for persistent breach. See Part F: (*Services*).

[358] See Standard Clause b(ii) below for a list of these events.

[359] See Part O: 69(*Step-in: Standard Direct Agreement*) for the definition of Pre-termination Notice.

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Standard Clause

Termination for Private Party Default

(a) *Notification*

The Private Party shall notify the Institution of the occurrence, and details, of any Private Party Default and of any event or circumstance which is likely, with the passage of time or otherwise, to constitute or give rise to a Private Party Default, in either case promptly on the Private Party becoming aware of its occurrence.

(b) *Institution's Options*

On the occurrence of a Private Party Default, or within a reasonable time after the Institution becomes aware of the same, the Institution may:

(i) *in the case of the Private Party Default referred to in Clauses (a), (b), (c), (d), (e) and (j),*[360] *terminate this PPP Agreement in its entirety by notice in writing having immediate effect;*

(ii) *and while the same is subsisting, in the case of any other Private Party Default referred in sub-Clauses (f), (g), (h), (i), ,(k), (l), (m), (n) and (o)* [361] *serve notice of default on the Private Party requiring the Private Party at the Private Party's option either:*

(aa) *to remedy the Private Party Default referred to in such notice of default (if the same is continuing) within [x] Business Days of such notice of default; or*

(bb) *to put forward within 20 (twenty) [x] Business Days of such notice of default a reasonable programme for remedying the Private Party Default. The programme shall specify in reasonable detail the manner in, and the latest date by, which such Private Party Default is proposed to be remedied. The Private Party shall only have the option of putting forward a programme in accordance with this Clause if it*

[360] These are meant to cover those Private Party Defaults that are not capable of being remedied or which will give rise to summary termination rights.

[361] These are Private Party Defaults that are capable of being remedied.

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first notifies the Institution within [x] Business Days of such notice of default that it proposes to do so.

(c) *Remedy Provisions*

(i) *Where the Private Party puts forward a programme in accordance with Clause (b), the Institution shall have [x] Business Days from receipt of the same within which to notify the Private Party that it does not accept the programme, failing which the Institution shall be deemed to have accepted the programme. The Institution shall act reasonably in rejecting the programme. Where the Institution notifies the Private Party that it does not accept the programme, the Parties shall endeavour within the following [x] Business Days to agree any necessary amendments to the programme put forward. In the absence of agreement within [x] Business Days, the question of whether the programme (as the same may have been amended by agreement) will remedy the Private Party Default in a reasonable manner and within a reasonable time period (and, if not, what would be a reasonable programme) may be referred by either Party for resolution in accordance with Clause [x] (Fast-track Dispute Resolution).*

(ii) *If:*

(aa) *the Private Party Default notified in a notice of default is not remedied before the expiry of the period referred to in the notice; or*

(bb) *where the Private Party puts forward a programme which has been accepted by the Institution or has been determined to be reasonable, the Private Party fails to achieve any element of the programme or to complete the programme by the specified end date for the programme (as the case may be); or*

(cc) *any programme put forward by the Private Party is rejected by the Institution as not being reasonable, and the dispute resolution procedure does not find against that rejection,*

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then the Institution may, subject to the Lenders' rights under the Direct Agreement,[362] terminate this PPP Agreement in its entirety by written notice to the Private Party with immediate effect; provided that for the purposes of Clause (d)(ii) if the Private Party's execution of the programme is adversely affected by the occurrence of an event of Force Majeure or a Relief Event then, subject to the Private Party complying with the mitigation and other requirements in this PPP Agreement concerning Force Majeure or Relief Events (as the case may be), the time for execution of the programme or any relevant element of it shall be deemed to be extended by a period equal to the delay caused by the Force Majeure event or Relief Event (as the case may be) which is agreed by the Parties or determined in accordance with Clause [x] (Fast-track Dispute Resolution).

(d) Institution's Costs

(i) The Private Party shall reimburse the Institution with all costs incurred by the Institution in exercising any of its rights in terms of this Clause. The Institution should take reasonable steps to mitigate such costs.

(ii) The Institution shall not exercise, or purport to exercise, any right to terminate this PPP Agreement except as expressly set out in this PPP Agreement. The rights of the Institution (to terminate or otherwise) under this Clause are in addition (and without prejudice) to any other right which the Institution may have in law to claim the amount of any direct loss or damages suffered by the Institution on account of the acts or omissions of the Private Party (or to take any action other than termination of this PPP Agreement).

55.4 Termination for Force Majeure

To the extent that an event of Force Majeure has occurred and the Parties have been unable to agree upon a mutually acceptable solution for dealing with the consequences of the event of Force Majeure, either Party should be entitled to terminate the PPP Agreement. The event of Force Majeure will by this time

[362] See Part O: 68 (*Step-in: By the Lenders*).

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have subsisted for a substantial period[363] during which all or at least a material portion of the Project Deliverables would not have been performed. The Private Party should be compensated on termination for Force Majeure (see Section 611 (*Compensation on Termination for Force Majeure*).

Standard Clause

Termination for Force Majeure

If, in the circumstances referred to in Clause [x] (Force Majeure) the Parties have failed to reach agreement on any modification to this PPP Agreement pursuant to that Clause within [x] [364] *months of the date on which the Party affected serves notice on the other Party in accordance with that Clause, either Party may at any time afterwards terminate this PPP Agreement by written notice to the other Party having immediate effect, provided always that the effects of the relevant events of Force Majeure continue to prevent either Party from performing any material obligation under this PPP Agreement.*

55.5 Termination for Corrupt Acts

55.5.1 The "Corrupt Acts" provisions in this Standardisation are aimed at all types of bribery, corruption and fraud perpetrated against the Institution in connection with the procurement and the ongoing performance of the PPP Agreement. It includes gifts, payments and all other Corrupt Acts. In this Section 55.5 they are all referred to as "Corrupt Acts".

55.5.2 The PPP Agreement must deal comprehensively with the consequences of Corrupt Acts. It must make provision for the Institution to terminate the PPP Agreement for Corrupt Acts in certain circumstances.

55.5.3 As the Institution's ultimate remedy for any Corrupt Act is severe, the prescribed approach allows the Private Party the opportunity to avoid termination in the circumstances described below:

[363] See Part J:48 (*Relief Events, Compensation Events and Force Majeure: Force Majeure*).

[364] The market practice has been for this period to be 180 days in any 365 day period.

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55.5.3.1 if the Corrupt Act is committed by the Private Party, a Shareholder, any director[365] of the Private Party or any director of a Shareholder, any employee of the Private Party acting under the authority of or with the knowledge of a director of the Private Party, or any employee of a Shareholder acting under the authority of or with the knowledge of a director of the Shareholder, then in any such case the Institution may terminate the PPP Agreement on notice of a minimum period as specified in the PPP Agreement and on payment by it of the full amount of the Debt (save as provided in Section 622 (*Compensation on Termination for Corrupt Acts*)). In addition, the Institution may recover from the Private Party the greater of any losses that it suffers as a result of the Corrupt Act and an amount equal to the value of the gift in question. If the Corrupt Act is the result of the action of any such employee acting on his or her own, then the Private Party should cause that employee's role in the Project to be terminated and, if a replacement is needed, cause that employee to be replaced within a specified period, which should be reasonable. If this is not done, then the PPP Agreement can be terminated on the same basis as would have applied if the employee had not been acting on his or her own;

55.5.3.2 if the breach is committed by a Subcontractor, a director of a Subcontractor or an employee of a Subcontractor acting under the authority of or with the knowledge of a director of the Subcontractor, then the Institution may terminate the PPP Agreement as if this were a Corrupt Act of the Private Party, but on notice of a minimum period as specified in the

[365] The term "director" as used in this Section 55.5 applies to an executive or non-executive director.

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PPP Agreement, unless the Private Party replaces the relevant Subcontractor within the notice period. If the Corrupt Act is that of an employee of a Subcontractor acting on his or her own, then the Private Party must cause the Subcontractor to terminate that person's involvement in the Project and, if needed, procure a replacement within a specified period. If neither is done, then the PPP Agreement can be terminated on the same basis as if it were a Corrupt Act by the Private Party;

55.5.3.3 if a second-tier subcontractor or a supplier, a director of such subcontractor or supplier or an employee of such person acting under the authority or with the knowledge of a director of that subcontractor or supplier, as the case may be, commits the Corrupt Act, then the Institution may terminate the PPP Agreement on notice of a minimum period as specified in the PPP Agreement as if this were a Corrupt Act of the Private Party, unless within a specified period after it has given notice of the Corrupt Act to the Private Party, the Private Party causes such subcontractor's or supplier's involvement in the Project to be terminated and, if needed, a replacement subcontractor or supplier to be appointed; and

55.5.3.4 where the Corrupt Act is committed by a Lender or involves a director of a Lender or an employee of a Lender not acting of his or her own accord but under the authority or with the knowledge of a director of the Lender (the "**Corrupt Lender**"), the termination of the PPP Agreement will not take effect if within the termination notice period the Private Party causes the Corrupt Lender's involvement in the co-financing of the Debt to be terminated and its outstanding financial commitment and participation in the Debt

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to be taken up by another Qualifying Financial Institution(s).[366] If an employee of a Lender was acting of his or her own accord, then the termination of the PPP Agreement will not take effect if the employee's involvement in the Project is terminated and, where necessary, he or she is replaced. Failing the termination of the involvement of the Corrupt Lender as aforesaid or, where an employee of a Lender was acting of his or her own accord then the termination of the involvement of such employee (and his or her replacement by another employee, if necessary), the PPP Agreement will terminate.

Standard Definition

*"**Corrupt Act**" means:*

(a) offering, giving or agreeing to give to the Institution or any other organ of state or to any person employed by or on behalf of the Institution or any other organ of state any gift or consideration of any kind as an inducement or reward:

(i) for doing or not doing (or for having done or not having done) any act in relation to the obtaining or performance of this PPP Agreement or any other contract with the Institution or any other organ of state; or

(ii) for showing or not showing favour or disfavour to any person in relation to this PPP Agreement or any other contract with the Institution or any other organ of state;

(b) entering into this PPP Agreement or any other contract with the Institution or any other organ of state in connection with which commission has been paid or has been agreed to be paid by the Private Party or on its behalf, or to its knowledge, unless before the relevant contract is entered into particulars of any such commission and of the terms and conditions of any such contract for the payment of such commission have been disclosed in writing to the Institution;

(c) committing any offence:

[366] See Part Q: 74(*Refinancing: Exemptions*) for the definition of "Qualifying Financial Institution".

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(i) under any law from time to time dealing with bribery, corruption or extortion;

(ii) under any law creating offences in respect of fraudulent acts; or

(iii) at common law, in respect of fraudulent acts in relation to this PPP Agreement or any other contract with the Institution or any other public body; or

(d) defrauding or attempting to defraud or conspiring to defraud the Institution or any other public body.

Standard Clause

Termination for Corrupt Acts

(a) The Private Party warrants that in entering into this PPP Agreement it has not committed any Corrupt Act.

(b) If the Private Party, any Shareholder, any Subcontractor or any Affiliate of any of them (or anyone employed by or acting on behalf of any of them) commits any Corrupt Act, then the Institution shall be entitled to act in accordance with Clauses (b)(i) to (viii) below:

(i) if the Corrupt Act is committed by the Private Party, any Shareholder, any director of the Private Party, any director of any Shareholder, or any employee of the Private Party or of any Shareholder acting under the authority of or with the knowledge of a director of the Private Party or such Shareholder, as the case may be, then in any such case, the Institution may terminate this PPP Agreement with immediate effect by giving written notice to the Private Party;

(ii) if the Corrupt Act is committed by an employee of the Private Party or of any Shareholder acting of his or her own accord, then in any such case, the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of the Private Party's receipt of such notice that employee's involvement in the Project is terminated and (if necessary) the performance of any part of the Project Deliverables previously performed by him or her is performed by another person;

(iii) if the Corrupt Act is committed by a Subcontractor, director of a Subcontractor or an employee of a Subcontractor acting under the authority or with the knowledge of a director of that Subcontractor, then in any such case, the Institution may give written notice to the Private Party of termination and this

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PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party terminates the relevant Subcontract and procures the performance of the relevant part of the Project Deliverables by another person, where relevant, in accordance with Clause [x] (Assignment);

(iv) *if the Corrupt Act is committed by an employee of a Subcontractor acting of his or her own accord, then the Institution may give notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party procures the termination of that employee's involvement in the Project and (if necessary) procures the performance of that part of the Project Deliverables previously performed by that employee to be performed by another person;*

(v) *if the Corrupt Act is committed by a Lender, a director of a Lender or any employee of a Lender acting under the authority or with the knowledge of a director of that Lender, then in any such case the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party procures the termination of such Lender's involvement in the Project (in any capacity whatsoever including, without limitation, as Lender under the Financing Agreements) and provides the Institution with satisfactory proof that such Lender's entire participations in the Debt and in any undrawn financial commitments under the Financing Agreements have been assumed by any Qualifying Financial Institution(s) (including any one or more of the remaining Lenders);*

(vi) *if the Corrupt Act is committed by any employee of a Lender acting of his or her own accord, then the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of the Private Party's receipt of such notice, that employee's involvement in the Project is terminated;*

(vii) *if the Corrupt Act is committed by any other person not specified in Clauses (b)(i) to (b)(vi) above but involved in the Project as a subcontractor or supplier to any Subcontractor or to the Private Party, then the Institution may give notice to the Private Party of termination and this PPP Agreement will terminate unless within [x] Business Days the Private Party procures the termination of such person's involvement in the Project and (if necessary) procures the performance of the relevant part of the Project Deliverables by another person; and*

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(viii) any notice of termination under this Clause shall specify:

(aa) the nature of the Corrupt Act;

(bb) the identity of the party or parties who the Institution believes has committed the Corrupt Act; and

(cc) the date on which this PPP Agreement will terminate in accordance with the applicable provisions of this Clause.

(c) Without prejudice to its other rights or remedies under this Clause, the Institution shall be entitled to recover from the Private Party, the greater of:

(i) the amount or value of the gift, consideration or commission which is the subject of the Corrupt Act; and

(ii) any direct losses sustained by the Institution in consequence of any breach of this Clause by the Private Party.

(d) Nothing contained in this Clause shall prevent the Private Party from paying any proper commission or bonus to its employees within the agreed terms of their employment.

(e) The Private Party shall notify the Institution of the occurrence (and details) of any Corrupt Act promptly on the Private Party becoming aware of its occurrence.

(f) Where the Private Party is required to replace any Subcontractor pursuant to this Clause, the provisions of Clause [x][367] *shall apply and be construed accordingly.*

56 EFFECTS OF TERMINATION

When either Party has exercised its right to terminate the PPP Agreement, the PPP Agreement will be terminated in accordance with its provisions and the Parties will generally no longer have any rights or obligations under this PPP Agreement. The PPP Agreement may, however, provide for certain provisions to survive its termination (such as certain indemnities) and the Parties will still have rights and obligations in respect thereof post termination. Also all rights and obligations of the

[367] This should refer to the clauses of the PPP Agreement dealing with the replacement of the Subcontractors. See Part S: 78.2(*Miscellaneous: Subcontracting*).

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Parties that have accrued prior to the termination may be enforced post termination. There are also certain rights and obligations that arise only as a result of termination of the PPP Agreement and these must be clearly provided for and must also be expressed to survive termination of the PPP Agreement. These should include the Private Party's obligation to clear the Project Site, the procedure for transfer of the Project Assets to the Institution[368] and the Private Party's obligations to assist in the transitional arrangements in relation to a new Private Party if the Institution decides to appoint one. It is important that these obligations on the part of the Private Party are clearly stipulated in the PPP Agreement so as to ensure that the exit of the Private Party does not result in any delay or interruption in the provision of the Services. In certain projects, such as IT projects, it may be necessary to develop a detailed schedule in this regard.

Standard Clause

Effects of Termination

(a) *Termination*

Notwithstanding any provision of this PPP Agreement, on service of a notice of termination, this PPP Agreement shall only terminate in accordance with the provisions of this Clause.

(b) *Continued Effect – No Waiver*

Notwithstanding any breach of this PPP Agreement by either Party, and without prejudice to any other rights which the other Party may have in relation to it, the other Party may elect to continue to treat this PPP Agreement as being in full force and effect and to enforce its rights under this PPP Agreement. The failure of either Party to exercise any right under this PPP Agreement, including any right to terminate this PPP Agreement and any right to claim damages, shall not be deemed a waiver of such right for any continuing or subsequent breach.

(c) *Continued Performance*

Subject to any exercise by the Institution of its rights to perform, or to procure a third party to perform, the obligations of the Private Party, the Parties shall

[368] See Section 57 (*Termination: Handback*).

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continue to perform their obligations under this PPP Agreement, notwithstanding the giving of any notice of default or notice of termination, until the termination of the PPP Agreement becomes effective in accordance with the provisions of this Clause.

(d) *Transfers to Institution of Assets, Contracts, etc. on Termination Only*[369]

On termination of this PPP Agreement in accordance with its terms for any reason:

(i) *if that occurs prior to the Service Commencement Date, in so far as any transfer shall be necessary fully and effectively to transfer the Project Site*[370] *to the Institution, the Private Party shall transfer to, and there shall vest in, the Institution such part of the Works and/or the Facilities as shall have been constructed and such items of the plant and equipment*[371] *as shall have been procured by the Private Party, and if the Institution so elects:*

(aa) *all plant and all materials on the Project Site or required for the purposes of completing the Works shall remain available to the Institution for the purposes of completing the Works; and*

(bb) *the construction plant shall remain available to the Institution for the purposes of completing the Works, subject to payment of the Private Party's reasonable costs;*

(ii) *if the Institution so elects, the Private Party shall procure that any of the Subcontracts specified by the Institution are assigned to the Institution or any third party nominated by it; provided that where termination occurs under Clause [x][the Clause dealing with Institution Default], the consent of the relevant Subcontractor(s) shall be required. Where the Institution does not so elect, or any Subcontractor whose consent is required refuses that consent, the Private Party shall procure that all relevant Subcontracts automatically terminate when this PPP Agreement terminates.*[372]

(e) *Transfers to Institution on Termination or Expiry*

[369] This may need to be amended to include project-specific provisions (for example, relating to equipment, IT, planning, land and Institution assets or information, and so forth). The Institution should consider what protection is required to ensure compliance with the handback provisions (see Section 57 (*Termination: Handback*)) on a project-specific basis (taking into account the nature, importance and value of the Project Assets to which the handback provisions will apply).

[370] This assumes that the Private Party has title in respect of the Project Site. In such event, the Project Site should not be encumbered as it will be required by the Institution to ensure continuation of the Services. To the extent that the Institution has made the Project Site available, as has been the market practice more often than not, this provision is not necessary.

[371] Institution to add other project-specific items.

[372] The Institution's election will, however, not be triggered by the service of any "Pre-termination Notice" as defined in the Direct Agreement.

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On termination of this PPP Agreement for any reason in accordance with its terms or within [x] days[373] *prior to the Expiry Date, the Private Party shall:*

(i) *hand over to, and there shall vest in, the Institution, free from all encumbrances, the Project Assets,*[374] *which in the case of expiry or termination of this PPP Agreement at the end of the Project Term shall be in the state required in accordance with Clause [x] (Handback); or*

(ii) *procure that any Subcontractor shall (as the case may be), transfer to the Institution, free from any security interest full and unencumbered title in and to all or any part of the Project Assets required by the Institution in connection with the Project Deliverables;*

(iii) *procure that any Licensed Intellectual Property shall be provided to the Institution and the Institution shall, to the extent possible, be granted a perpetual non-exclusive, royalty-free licence to use such Licenced Intellectual Property;*

(iv) *deliver to the Institution (as far as not already delivered to the Institution) one complete set of:*

(aa) *"as built drawings" showing all alterations made to the Facilities since the commencement of operation of the Facilities;*

(bb) *maintenance, operation and training manuals for the Facilities to the extent that they exist or the Private Party has an obligation in terms of this PPP Agreement to acquire or prepare them; and*

(cc) *the historical operating data and plans of the Facilities, its furniture, fittings and equipment in a format acceptable to the Institution;*

(v) *use all reasonable endeavours to procure that the benefit of all manufacturer's warranties in respect of mechanical and electrical plant and equipment used or made available by the Private Party under this PPP Agreement and included in the Project Assets are assigned, or otherwise transferred, to the Institution;*

(vi) *deliver to the Institution [the information referred to in the Clauses dealing with employment and pension matters and the records referred to in the Clause dealing with records and reports] except where such documents are required by law to be retained by the Private Party or*

[373] The exact time will vary from project to project.

[374] This must refer only to those Project Assets that the Institution, at the RFP stage, informed the Private Party that it will require at the end of the Project Term and which were not to be encumbered by the Private Party. See Part G:36 (*Project Assets: Security Over Project Assets*).

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any Subcontractor concerned (in which case complete copies shall be delivered to the Institution);[375]

(vii) ensure that provision is made in all relevant contracts of any description whatsoever to which the Private Party or any Subcontractor is a party to ensure that the Institution will be in a position to exercise its rights, and the Private Party will be in a position to comply with its obligations, under this Clause (e);

(viii) remove from the Project Site all property not required by the Institution pursuant to Clause (d) (Transfer to Institution of Assets, Contracts, etc.) and if it has not done so within [x][376] *Business Days after any notice from the Institution requiring it to do so the Institution may (without being responsible for any loss, damage, costs or expenses) remove and sell any such property and shall hold any proceeds less all costs incurred for the credit of the Private Party;*

(ix) deliver to the Institution:

(aa) any keys, remote access apparatus and computer access cards to the Facilities; and

(bb) without prejudice to Clause [x] (Intellectual Property), any copyright licences for any computer programmes (or licences to use the same) necessary for the operation of the Facilities (but excluding computer programmes [which have been developed or acquired by the Private Party for its own use and not solely for the purposes of provision of any of the Services at the Facilities or the assignment or transfer of which is otherwise restricted]);[377] *and*

(x) vacate the Project Site and (without prejudice to Clause [x] (Handback)) shall leave the Project Site and the Facilities in a safe, clean and orderly condition.

(f) <u>Transitional Arrangements</u>

For a period of [x] months[378] *both before and after the Expiry Date or in the case of any earlier termination for the period from the service of notice of termination to [x] months after the termination date, the Private Party shall have the following obligations:*

375 This is only relevant if the PPP Agreement provides for the Institution to take over the employees.

376 This may vary depending on the specific project.

377 This depends on the approach taken in relation to Intellectual Property. See Part R: 77(*Intellectual Property*).

378 This will depend on the specific project.

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(i) the Private Party shall co-operate fully with the Institution and any successor providing services to the Institution in the nature of any of the Services or any part of the Services in order to achieve a smooth transfer of the manner in which the Institution obtains services in the nature of the Services and to avoid or mitigate in so far as reasonably practicable any inconvenience or any risk to the health and safety of the employees of the Institution and members of the public;[379]

(ii) If the Institution wishes to conduct a tender process with a view to entering into a contract for the provision of services (which may or may not be the same as, or similar to, the Services or any of them) following the expiry or earlier termination of this PPP Agreement, the Private Party shall co-operate with the Institution fully in such tender process including (without limitation) by:

(aa) providing any information which the Institution may reasonably require to conduct such tender excluding any information which is commercially sensitive to the Private Party (and, for the purposes of this sub-Clause, commercially sensitive shall mean information which would if disclosed to a competitor of the Private Party or Subcontractor give that competitor a competitive advantage over the Private Party or Subcontractor and thereby prejudice the business of the Private Party or Subcontractor but shall exclude any [information referred to in the Clause dealing with employment matters])[380]*; and*

(bb) assisting the Institution by providing all (or any) participants in such tender process with access on reasonable notice and at reasonable times to the Project Site and the Project Assets subject to the Private Party's safety rules and regulations.

(g) <u>Continuing Obligations</u>

Save as otherwise expressly provided in this PPP Agreement:

(i) termination of this PPP Agreement shall be without prejudice to any accrued rights and obligations under this PPP Agreement as at the date of termination; and

(ii) termination of this PPP Agreement shall not affect the continuing rights and obligations of the Private Party and the Institution under Clauses [ ] (Private Party Warranties),[381]*[ ] (Institution Warranties),*

[379] This assistance by the Private Party after the Expiry Date will no doubt have cost implications. The Institution may want to consider placing a limit, financially and otherwise, on this assistance as it will affect value for money.

[380] This depends on what has been agreed in relation to the take over of employees by the Institution.

[381] The Clauses referred to here must extend to all warranties given by the Private Party not limited to the warranties contained in the Standard Clause in Part C:8 (*General Obligations: Warranties*) but also including other warranties given by the Private Party including the warranty concerning Corrupt Acts.

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[ ] (Private Party Indemnities),[382] *[ ] (Limitations on Liability), [ ] (Project Site Agreement), [ ] (Project Site Conditions), [ ] (Employment Matters), [ ] (Payment), [ ] (Insurance), [ ] (Force Majeure), [ ] (Effects of Termination), [ ] (Compensation on Termination), [ ] (Intellectual Property), [ ] (Confidentiality), [ ] (Reporting Requirements), [ ] (Access to Information), [ ] (Dispute Resolution), [ ] (Fast-track Dispute Resolution), [ ] (Notices and Legal Service), [ ] (Governing Law and Jurisdiction) or under any other provision of this PPP Agreement which is expressed to survive termination or which is required to give effect to such termination or the consequences of such termination.*

57 HANDBACK

57.1 The expected condition of the Project Assets on expiry of the PPP Agreement must be agreed with the Private Party and provided for in the PPP Agreement. In so far as the Institution requires the use of the Project Assets in order to continue the performance of the Services either itself or by engaging another Private Party after the Expiry Date, provision should be made for transfer of possession of, and unencumbered title over, the Project Assets to the Institution on the Expiry Date. At the Signature Date, the Parties must agree which Project Assets will be required by the Institution at the end of the Project Term. It is only these agreed Project Assets to which this Section 57 applies.[383]

57.2 If the Project Assets are to be transferred to the Institution[384] on the Expiry Date they must be in a condition where they have some remaining useful life in order to enable the Institution to provide the Services. The intention is not for the Private Party to ensure that the Institution may use the Project Assets indefinitely, but merely to ensure that the Institution is not in the position, at expiry of the Project Term, where all the Project Assets required for the

[382] If there are any Institution Indemnities, then the relevant Clause should also be referred to here.

[383] Institutions should inform bidders, at the RFP stage, of those assets that it will require at the end of the Project Term.

[384] In so far as the Institution does not already have possession of, or title to, them.

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Services have to be replaced simultaneously. The assets therefore must have some residual value at the Expiry Date.

57.3 The residual value means the market value of the Project Assets or the duration for which those assets can still be used after expiry of the PPP Agreement ("**Residual Value**"). The Residual Value required will vary from project to project.[385] For example, a PPP in the IT sector may require a much shorter remaining useful life in respect of the Project Assets than one in an accommodation project. It is also often not feasible or practical to have one standard that applies to all the Project Assets as a result of their varying nature and purpose. Project Assets could be grouped using criteria that would enable the Project Assets in a category to be dealt with in the same or similar fashion. To cater for the occasional Project Asset that might not meet the standards specified in the PPP Agreement, the concept of an average remaining useful life across a category of assets has been used in certain PPPs.

57.4 The PPP Agreement must accordingly provide for a procedure to be followed prior to the Expiry Date[386] in order to determine the condition of the Project Assets and whether the Private Party has complied with the obligations in relation to the condition of the assets. A procedure has to be agreed upon whereby a survey is conducted to examine the assets; a schedule is prepared which details all items that require remediation; a programme for remediation is developed; and the costs of such remediation are ascertained and inspections are held to ensure that the remediation work is properly completed.[387] As a means of ensuring that the Private Party complies with its obligations in

[385] Toll road projects have, for example, required that at the Expiry Date, the road be in a condition in which it could be used for at least three years, while a hospital project has required that categories of equipment have a remaining average useful life of at least one-third of the original useful life.

[386] This should still allow sufficient time to enable the necessary survey to be undertaken, a programme prepared and the remediation works, if any, in respect of such Project Assets to be completed, inspected and accepted prior to the Expiry Date.

[387] In projects where the Institution will not require the assets at Expiry Date, it may be possible to shift the Residual Value risk to the Private Party. The User Charges would have to be adjusted taking into account the Residual Value of the assets at Expiry Date that the Private Party may be able to realise.

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relation to the condition of the Project Assets at the Expiry Date, it is not uncommon to require the Private Party to provide the Institution with acceptable security. This security could take the form of final bonds, reserve accounts or deductions from the Unitary Payment (See Part F:32 (*Services: Maintenance in General*)).

58 COMPENSATION ON TERMINATION

58.1 General

The PPP Agreement must clearly stipulate that the Institution will pay no compensation to the Private Party on expiry of the Project Term. The Private Party will seek compensation from the Institution in the event that the PPP Agreement is terminated prior to the Expiry Date. The value of compensation payable to the Private Party on an early termination will vary depending on the reason for that termination. Where the termination is a result of Institution Default, the value of the compensation payable to the Private Party is usually greater than that payable in the event of Force Majeure termination or termination as a result of a Private Party Default. The compensation payable on Private Party Default should be substantially less than the compensation payment on termination for any other reason.

58.2 Set-off

The Institution should have the right to set-off amounts due to it by the Private Party against any compensation due to the Private Party on termination for Private Party Default. This right of set-off should not be limited and there should be no ring-fencing of the Debt in these circumstances. On termination for reasons other than Private Party Default, it is acceptable for this right of set-off to be limited so that the Debt is ring-fenced and the Lenders afforded some protection.

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59 COMPENSATION ON TERMINATION FOR INSTITUTION DEFAULT

In the event of termination as a result of Institution Default, the compensation payment must include the total amount outstanding in respect of the Debt, including any breakage costs as well as breakage premiums. The compensation payment also ought to cover all amounts due by the Private Party to third parties in relation to the Project, for example, Subcontractor Costs. Subcontractor Costs should be carefully calculated so as not to extend beyond first-tier Subcontractors, and to include future Subcontractor (first-tier only) losses of profits for a specified time period only. In determining the period for which the Institution should compensate the Private Party for Subcontractor losses of profits, the Institution shall take into account (i) the particular sector or industry; (ii) how soon before the Subcontractor is likely to source another project; and (iii) the expired duration of the Project Term so that the greater the unexpired portion of the Project Term, the greater the amount that the Institution should pay. Subcontractor losses of profits should in any event be compensated for a period of between one to five years, taking into account the above factors. As the PPP market in Pakistan develops, this time period should decrease.[388] As the termination is not due to any fault on the part of the Private Party, fairness dictates that the compensation include Shareholder Loans as well as a return on Equity.

59.1 Interest Rate Risk

59.1.1 Precisely what will be covered by "Debt" must be clearly defined.

59.1.2 Debt should cover all types of debt, save for Shareholder Loans.

[388] The Institution should consider this issue at the time of evaluating the bid proposals and the RFP should seek a response from the bidders in this regard.

To the extent that the employees are transferred to the Institution on termination, redundancy costs must be excluded.

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59.1.3 In almost every project, interest rates will initially be stipulated in the Financing Agreements as variable rates. The standard practice is for a variable rate to be nominated, and then on or shortly before the Signature Date, the appropriate calculations to be done and an interest rate swap to be concluded so as to introduce a fixed rate. The Financial Model is then run again and the effect of this on various costs is calculated and set.

59.1.4 The bidders must, during the RFP process, demonstrate in their bids how the interest rate risk will be managed by means of hedging arrangements and how their interest rate hedging arrangements, if any, will achieve value for money. The bidders must also consider affordability when deciding on the appropriate strategy for managing the interest rate risk.

59.1.5 The prescribed position is that the interest rate is the Private Party's risk. The Institution must not bear any interest rate risk either during the Project Term or in relation to its compensation obligations on certain early termination. It is standard practice for the Private Party to carry all interest rate risk. In certain types of termination it may be necessary for the Institution to compensate the Private Party for the costs associated with terminating these hedging arrangements. A distinction must be made between breakage costs, being the direct costs associated with unwinding the hedging arrangements, and breakage premiums, being the penalties payable for unwinding the hedging arrangements. In the event of termination for Institution Default, fairness dictates that the compensation payable should include breakage costs as well as breakage premiums.

59.2 Exchange rate/currency risk

59.2.1 All amounts provided for under the PPP Agreement should be stipulated and payable in Pakistan Rupees.

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59.2.2 The prescribed position is that Institutions should not accept exchange rate or currency risk. This risk must be borne by the Private Party.

59.2.3 In some PPPs there may be situations that oblige Private Parties to effectively accept long-term foreign currency obligations, so that they will have to enter into currency hedging arrangements. The Lenders or hedging banks will often seek to have the Institution assume some or all of the hedging liabilities if there is an early termination of the PPP Agreement.

59.2.4 Where the Institution is a Provincial Government, including a provincial public entity for whose financial obligations the Provincial Government is primarily responsible, this may require the prior permission of the Federal Government in so far as such hedging liability falls within the definition of 'loan' by the Provincial Government[389].

Federal Institutions may only do so if the Ministry of Finance so permits.

59.2.5 As in the case of interest rate risk, the bidders must demonstrate during the RFP stage how exchange rate and currency risks will be managed and how they impact affordability.

59.2.6 The prescribed position is that Institutions should not accept any hedging liabilities, whether by guaranteeing hedging payment obligations (in Pakistan Rupees or any other currency) during the Project Term or by assuming some or all of the hedging obligations on early termination or by compensating for any costs of unwinding the hedge on early termination. In certain types of termination it may be necessary for the Institution to compensate the Private Party for the costs associated with terminating these hedging arrangements. A distinction must be made

[389] Article 167(3) of the Constitution.

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between breakage costs, being the direct costs associated with unwinding the swap, and breakage premiums, being the penalties payable for unwinding the swap arrangements. In the event of termination for Institution Default, fairness dictates that the compensation payable should include breakage costs as well as breakage premiums.

59.3 Shareholder Loans/Equity

59.3.1 Return on equity (including pure equity (that is, "Equity" as defined) and the Shareholder Loans) compensation can be calculated using several approaches.

59.3.1.1 One approach is for compensation to reflect the market value of both Equity and Shareholder Loans. The purpose is to allow the Shareholders to take the full benefit of good Private Party performance but bear the risks associated with poor performance. The Institution would pay an amount for both Equity and Shareholder Loans based on their market value on a going concern basis immediately prior to termination, that is, the amount for which the Equity and Shareholder Loans could have been sold to a willing buyer at the relevant date (the calculation being based on the assumption that there had been no Institution Default and that both Equity and Shareholder Loans were freely transferable). The market valuation[390] will reflect the extent to which any such Project Assets are not transferred to the Institution on termination,[391] the value of anticipated future cash flows (both revenue and costs); the risk allocation under the PPP Agreement; and market appetite for contracts of a similar nature. It will also take into account the

[390] The Pakistani PPP market will require a certain level of maturity before this approach can be implemented.

[391] This is, however, rare as in most cases the Project Assets are, to the extent that title is not already vested in the Institution, transferred to the Institution on termination as they are required for the continued provision of services.

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value of the Project Assets (including any cash balances) held by the Private Party at the Termination Date.

59.3.1.2 The alternative approach prescribed in the Unitary Payment Standardisation is for compensation to reflect the base case return on equity (Equity plus Shareholder Loans) for the entire duration of the PPP Agreement or for the remainder duration of the PPP Agreement after the date of termination. The result there is to provide the Shareholders with the returns they expected from the Project at the outset, regardless of actual project performance (whether better or worse than expected). The compensation payment is the amount which, when taken together with all amounts already paid in respect of Equity (by way of dividends and other distributions) and Shareholder Loans (by way of interest and principal repayments) and taking into account the actual timing of all such payments, provides the Shareholders with their base case return on equity as agreed at the Signature Date.

59.3.1.3 The alternative method in the Unitary Payment Standardisation is premised on that the market or demand risk in Unitary Payment PPPs rests with the Institution. In User Pay PPPs, the market or demand risk is assumed by the Private Party; to compensate the Private Party on the same basis as in Unitary Payment Standardisation would translate in the market or demand risk being retransferred to the Institution.

59.3.1.4 The prescribed approach for User Pay PPPs in relation to compensation in relation to return on equity (Equity plus Shareholder Loans) is to pay the lower of the Base Case Equity IRR and the Revised Equity IRR (as these terms are defined in Part

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A (*Preliminary: Definitions*). The Revised Equity IRR captures the market or demand risk for the account of the Private Party, by rebasing the return on Equity to the actual market or demand in the preceding three years. As the Private Party will commit to the Project in the expectation of earning the Base Case Equity IRR, compensation on the basis of a higher Revised Equity IRR will translate into a windfall for the Private Party and will require the Institution to pay an amount that was not foreseen and therefore not committed by the Institution; the lower Base Case Equity IRR in that case will constitute adequate, pre-committed return to the Private Party. Where the Base Case Equity IRR has already been achieved, no payment should be made.

59.3.2 The bidders should be instructed in the RFP to submit a mandatory bid on the basis of the Base Case Equity IRR as this is a quantifiable cost to the Institution from financial close. If the bidders wish to submit a bid on the basis of the first option, this should be done as an alternative bid.

Standard Clause

Compensation on Termination for Institution Default

On termination of this PPP Agreement as a result of an Institution Default, the Institution shall pay[392] *the Private Party an amount equal to the aggregate of:*

(a) an amount equal to the Debt and all fees, costs, expenses, breakage costs and breakage premiums in connection with any Financing Agreement;

(b) Subcontractor Costs; and

(c) [Equity Compensation]; and[393]

[392] The ring-fencing of Debt in relation to the Institution's right of set-off against the compensation payments in these circumstances may be considered.

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(d) redundancy payments for employees of the Private Party not transferring to the Institution that have been or will reasonably be incurred by the Private Party as a direct result of the termination of this PPP Agreement,[394]

***less**, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

(i) all credit balances on any bank accounts, held by or on behalf of the Private Party on the Termination Date and the value of any right of the Private Party or the Lenders to receive insurance proceeds or any proceeds pursuant to letters of credit and of any such proceeds actually received by them (save where such credit balances or proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;

(ii) all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less liabilities of the Private Party or the Lenders properly incurred in connection with this PPP Agreement; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(aa) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and

(bb) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms; and

(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

[393] This sub-Clause (c) will have to be drafted to reflect the Shareholder Loans (plus outstanding interest thereon) and Equity compensation that is agreed in terms of Section 59.3.

[394] See footnote 388 regarding the exclusion of these costs.

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60 COMPENSATION ON TERMINATION FOR PRIVATE PARTY DEFAULT

60.1 Introduction

60.1.1 One question that may be asked is why compensation should be paid to the Private Party when it has defaulted. Under a typical service contract, not only would no compensation be paid but the defaulting party could also expect the innocent party to bring claims for damages. The reason that compensation is paid is that a failure to compensate could unfairly benefit the Institution. This would be the case, for example, where a particular asset is developed to deliver the Services and the Institution is entitled to have the asset transferred to it on a termination without compensating the Private Party for its value.

60.1.2 "No compensation" models have also been driven by a proper concern that, on Private Party Default, Lenders should be encouraged to step–in and rescue the Project. They do, however, expose the public sector to the charge that it is seeking a possible windfall gain in the event that termination occurs (for example, if it takes over a valuable asset), although this is refutable if the Institution agrees to pay the market value of any assets to be transferred to it. These models may also serve to increase the cost of Projects to the public sector by forcing the bidders to take a conservative approach to risk pricing, liquidated damages and the limits on liability they require from the Subcontractors.

60.1.3 The amount of compensation payable on Private Party Default termination is one of the key commercial issues for all parties concerned. The question which is then relevant is how best to assess what is an appropriate level of compensation for Private Party Default.

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60.1.4 Compensation based on the NPV of future cash flows is not appropriate as the Private Party is not penalised for poor performance. Also, compensation based on NPV calculations may be sufficient to repay Debt in full and this may remove the Lenders' incentive to step-in and remedy the situation and may result in a termination, which would otherwise have been avoidable.

60.1.5 The market value approach described below represents a balance between protecting the Institution's interests and not imposing unreasonable penalties on the Private Party for its default. It also encourages the Lenders to step-in and rescue the Project instead of simply relying on the termination payment to recover their Debt (see Part O: 68 (*Step-in: By the Lenders*)), while taking into account poor performance by the Private Party as this will be reflected in the price that prospective bidders would be willing to pay for the PPP Agreement.

60.1.6 The major criticism of the market value approach is that the Pakistani PPP market is not mature enough to determine, with reasonable accuracy, the existence of a liquid market, which is an important element of the market value approach.

60.1.7 The Lenders' concerns are that the market value approach may result in a substantial portion of the Debt not being recovered. Therefore, during these developing stages of the PPP market in Pakistan, these Lender concerns are catered for by providing that an agreed percentage of the Debt be repaid where, following the retendering of the Project, the Adjusted Estimated Project Value[395] pursuant to the market value approach yields an amount that is less than that percentage.

[395] See the Standard Clause in Section 60.5 (*No Retendering Procedure*) for a definition.

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60.1.8 The market value approach is, however, still viewed as the preferable route for calculating compensation for termination due to Private Party Default. Therefore while the concerns of the Lenders in relation to the market value approach are addressed in this Standardisation by payment of an agreed percentage of the Debt, the intention of the Approving Authority is, as the Pakistani PPP market develops, to eventually move away from any Debt-based compensation in favour of the market value approach exclusively. In the interim, however, the prescribed approach in this Standardisation is for compensation due on termination for Private Party Default to be the greater of the pre-agreed percentage of the Debt and the highest tender price that is received pursuant to the Project being retendered, or the greater of the pre-agreed percentage of the Debt and the Adjusted Estimated Project Value in the case where the Project is not retendered.

60.2 Market Value

60.2.1 The market value approach encourages the Lenders to step-in and rescue the Project if the Private Party defaults. If the Lenders fail to do so and the PPP Agreement is terminated, the compensation will be based on the market value of the unexpired portion of the Project Term or the agreed Debt percentage.

60.2.2 The advantages of this approach are that it:

60.2.2.1 does not saddle the Lenders with the responsibility of transferring the Project when there is no market for such projects;

60.2.2.2 allows Lenders to step-out if they have been unable to rescue the Project after stepping-in (see Part O:68 (*Step-in: By the Lenders*));

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60.2.2.3 increases co-operation among the Parties and the Lenders in order to rescue the Project;

60.2.2.4 preserves the Institution's position even where Lenders do not step-in;

60.2.2.5 does not give the Institution a windfall gain on termination; and

60.2.2.6 does not discriminate against different types of finance, Equity or Shareholder Loans.

60.2.3 If the Institution notifies the Private Party of its intention to terminate the PPP Agreement, the Lenders will, in terms of the Direct Agreement,[396] have the right to prevent termination either by stepping-in and remedying the default or by having the PPP Agreement transferred to a third party if there is a liquid market. If the Lenders demonstrate in accordance with the terms of the Direct Agreement that there is no liquid market and the Institution agrees or the Independent Expert determines that the Lenders have demonstrated that there is no liquid market, then there should be no retendering by the Institution and the PPP Agreement terminates automatically.

60.2.4 If the Institution disagrees and the Independent Expert determines the dispute in favour of the Institution, then the Institution may retender the PPP Agreement. The outcome of the retender will determine the compensation payable to the Private Party (subject to any Debt floor that is agreed). However if the outcome of the retendering results in the highest tender price being less than a pre-agreed percentage of the Debt, the Private Party should not be paid the highest tender price but rather the pre-agreed percentage of the Debt.

[396] See Part O: 69 (*Step-in: Standard Direct Agreement*).

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60.2.5 While the Lenders would probably accept the risk of Private Party's Default and any resultant termination, it is unlikely that they will agree to the retender of the remaining Project Term if there is no liquid market for similar types of PPPs. The market value approach caters for this probability in that if there is no liquid market pursuant to an RFQ, then the compensation is the Adjusted Estimated Project Value (subject to any Debt floor that is agreed).[397]

60.3 Retendering Option and Liquid Market

60.3.1 The retendering option and liquid market approach gives the Institution the flexibility of choosing whether or not to retender the PPP Agreement, following termination. This option should not be available to the Institution if the Lenders have stepped-in and have been unable to rescue the Project or "sell" the PPP Agreement because there is no liquid market for the PPP Agreement. During retendering, tariff negotiations are a possibility to be kept in view.

60.3.2 If the Institution could exercise the option under such circumstances, it would be taking advantage of there being no liquid market. In other circumstances, however, the Institution should have the right to choose whether to retender the unexpired Project Term or to have the Estimated Project Value calculated.

60.3.3 If there is no liquid market for the PPP Agreement and the PPP Agreement terminates, then the procedure set out in Section 60.5 (*No Retendering Procedure*) should be followed.

60.3.4 There will be a liquid market for the PPP Agreement if, following an RFQ issued in terms of either the PPP Agreement or the Direct

[397] See the Standard Definitions in Section 60 (*No Retendering Procedure*) for the definition of this term.

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Agreement if the Lenders have decided to step-in,[398] at least three bidders are pre-qualified. The Lenders should not be entitled to assert that there is no liquid market if they have not stepped-in in terms of the Direct Agreement.

60.3.5 The question is whether the market for contracts of this type in general is liquid (it is possible for there to be no bidders on retendering and there still to be a liquid market).[399] The relevant test is the state of the PPP market for similar contracts at the time when the liquid market test is run. What happens at the end of the Retendering Procedure, could very well be quite different. The apparent lack of maturity of the PPP market makes it difficult to ascertain the existence or not of a liquid market by means of a theoretical exercise. Given the current market conditions, the most feasible way of ascertaining the existence of a liquid market would be to issue an RFQ. If at least three bidders are pre-qualified pursuant to the RFQ, then it would be fair to conclude that a liquid market exists. If there is a liquid market for PPPs and the Institution elects to retender the PPP Agreement, the market will determine the market value of the PPP Agreement (that is, if there are no bidders for the retendering of the PPP Agreement the market has, by definition, determined that the market value of the PPP Agreement is less than or equal to zero). While this incentivises the Lenders to step-in in order to exercise greater control on retendering of the PPP Agreement,[400] the Pakistani PPP market is however not mature enough for the Lenders to accept the risk of a market value that is significantly less than the Debt as the likelihood of it materialising is significant. For this reason if the retendering route is

[398] See Part O: 68 (*Step-in: By the Lenders*).

[399] This is because the liquid market test is determined on the basis of whether any bidders have pre-qualified pursuant to an RFQ. An RFQ is issued by the Institution prior to the issue of an RFP. It is therefore possible for an RFQ to result in at least three bidders pre-qualifying (indicating a liquid market) but for the subsequent RFP not to result in the receipt of any bids.

[400] See Part O: 68 (*Step-in: By the Lenders*).

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pursued, the prescribed approach is for the compensation payable to be the greater of the highest tender price received pursuant to the retendering of the Project and a pre-agreed percentage of the Debt.

60.3.6 If the PPP Agreement is retendered and a new Private Party appointed, the price for which the PPP Agreement is "sold" would be determined through a competitive bidding process (subject to any Debt floor) controlled by the Institution.

Standard Definition

*"**Agent**" means the agent of the Lenders from time to time.*

Standard Clause

Compensation on Termination for Private Party Default

Retendering Election

(a) Subject to Clause (c), the Institution shall be entitled[401] either to:

(i) retender the provision of the Services in accordance with Clause [x] (Retendering Procedure); or

(ii) require an expert determination in accordance with Clause [x] (No Retendering Procedure).

(b) Subject to Clause (c), the Institution shall notify the Private Party of its election on or before the date falling [x] days after the Termination Date.

(c) The Institution shall not be entitled to elect to retender the provision of the Services for the unexpired portion of the Project Term if the Lenders have stepped-in, and the Agent has demonstrated to the Institution that there are less than 3 (three) parties (each meeting the criteria in paragraph (a), (b) and (c) of the definition of "Substitute Private Party" in the Direct Agreement) who have pre-qualified pursuant to an RFQ issued by the Lenders for the provision of the Services for the unexpired

[401] The presumption should be in favour of a retender.

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portion of the Project Term, in accordance with the Direct Agreement.[402]

60.4 Retendering Procedure

60.4.1 The Institution may in the circumstances referred to in Section 60.3 (*Retendering Option and Liquid Market*) choose to retender the unexpired portion of the Project Term on its original terms and pay the proceeds of the sale (less the Institution's costs) to the former Private Party.

60.4.2 Bidders must be invited to tender on the same scope of Services and User Charges profile as that set out in the PPP Agreement. The Institution should therefore be in the same position that it would have been in had the PPP Agreement not been terminated, save for the tender process disruption. The Institution should not change either the scope of the Services or the User Charges profile on retender, unless agreed with the Private Party (and the Lenders). Alternatively, the Institution may pay the Adjusted Estimated Project Value of the PPP Agreement.[403]

60.4.3 Institutions must make every attempt to obtain *bona fide* responses to the RFP including requesting bid bonds,[404] where appropriate. The RFP must specify the remediation works, if any, that need to be undertaken in order to remedy the Private Party Default.

60.4.4 The User Charges profile should ensure that bids with a positive monetary value are received from prospective bidders pursuant to the RFP, particularly if termination occurs post completion of the Works.

[402] The compensation payable to the Private Party in such circumstances will be determined in accordance with the procedure set out in Section 60.5 (*No Retendering Procedure*).

[403] See Standard Definition below.

[404] The value of the bid bond will depend on the stage of the Project Term at which the PPP Agreement is terminated, for example, a higher bid bond would be required during the construction phase than late in the operations phase of the PPP Agreement.

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60.4.5 On the Termination Date, the obligation of the Private Party to provide the Services and the right to charge User Charges will cease. The Institution however will require that the Services, to the extent possible despite termination, continue to be available until a new Private Party takes over the Project (or the Institution itself is able to continue to provide the Services, which may not be possible in Projects requiring a large skilled or semi-skilled staff). Accordingly, it will serve the end users to require the Private Party to continue to provide the Services to the extent possible until a replacement new Private Party takes over the Project. However, as the right of the Private Party to charge User Charges post-termination is an additional revenue stream, fairness dictates that this stream of revenues be treated distinctly and deducted from the compensation payable on termination (which will be determined with reference to the earlier occurred Termination Date). Such post-termination revenue stream is referred to as the "Post Termination Service Amount"[405] which should represent the value received by the end users during this interim period, less (i) deductions for any costs incurred by the Institution, including the costs of providing alternative services (where the full range of Services is not provided post termination), (ii) the accrued value of Penalty Deductions in respect of Service unavailability or performance shortfall in the interim period, and (iii) any rectification costs.

60.4.6 The Private Party's liability for Penalty Deductions should continue beyond the Termination Date; the right to earn revenues from the Project for the interim period should not be independent of the obligation to provide the available Services up to the contractually agreed standard, so as not to translate into a windfall for the Private Party. However, the

[405] See Standard Definition below.

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Private Party should not be obliged to maintain the Performance Security beyond the Termination Date, as the accrued Penalty Deductions will be deducted from the compensation receivable by the Private Party.

60.4.7 The Institution will select the bid that represents best value for money. This may not necessarily be the highest bid. The Private Party should be paid compensation based on the highest-priced tender, irrespective of which bid the Institution accepts. The Institution's costs of retendering, and its costs of providing the services during the period from termination to conclusion of the New PPP Agreement, must be deducted from the highest-price tender. The difference is the adjusted highest tender price that will (if it is higher than the pre-agreed percentage of the Debt) be paid to the outgoing Private Party as compensation.

60.4.8 Neither Party should be allowed to delay the retendering process.

60.4.9 The Institution will be responsible for controlling the retendering process. The Lenders will usually by this point have decided not to exercise their step-in rights or, having exercised their step-in rights, will have been unsuccessful in remedying the default. They will nevertheless want to ensure that the tender process is conducted in a manner that will result in a fair market value for the PPP Agreement being received. This may be achieved by allowing the Lenders (through the Private Party) to appoint a third party (the "**Tender Process Monitor**") to monitor the retendering process. The Tender Process Monitor should be entitled to attend meetings, and review tender documentation and bids, but should not be entitled to require that the Institution have regard to any representation made by the Tender Process Monitor. See the diagram at the end of this Section 600 for a schematic representation of these provisions.

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60.4.10 The lack of maturity of the Pakistan PPP market may give rise to concerns on the part of the private sector, especially the Lenders, that the Debt or a significant portion thereof will not be repaid on termination as the retendering option could yield bids that do not accurately reflect the value of the Project or that result in a zero value.

60.4.11 In order to address these concerns during these developing stages of the Pakistan PPP market, the prescribed approach in this Standardisation is to compensate the Lenders for a pre-agreed portion of the Debt if the retendering results in a tender price that is less than that pre-agreed percentage of the Debt.

60.4.12 The total Debt outstanding should not be repaid as the termination is due to Private Party Default. The Debt should be reduced in order to determine the level of compensation that the Institution should pay in this event. At the original RFP stage, the Institution must request that the bidders bid on what percentage of the Debt they believe should be repaid in the event that, on retendering, the highest tender price is less than the Debt. The Institution must take advice from its financial advisors as to what is appropriately punitive in order to determine the percentage of the Debt that should be repaid in these circumstances. The percentage of the Debt that will be repaid must be agreed by the Parties at the Signature Date and incorporated into the PPP Agreement.

60.4.13 If, following retendering of the Project, the highest tender price that is received is less than the agreed percentage of the Debt, the Institution should pay the Private Party compensation based on the agreed percentage of the Debt instead of compensation based on the highest tender price received.

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60.4.14 Any compensation payable to the Private Party on termination due to Private Party Default should be net of any Post Termination Service Amounts earned by the Private Party, any amounts due to the Institution by the Private Party, the tender costs as well as any rectification costs.

Standard Definitions

*"**Adjusted Debt**" means [x][406] percent of the Debt*

***less**, to the extent it is a positive amount, the aggregate of:*

(a) any Post Termination Service Amounts earned by the Private Party to date;

(b) the Tender Costs;

(c) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date and the value of any right of the Private Party or the Lenders to receive insurance proceeds or any proceeds pursuant to letters of credit and of any such proceeds actually received by them (save where such credit balances or proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;

(d) all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements;

(e) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities of the Private Party or the Lenders properly incurred in carrying out its obligations under this PPP Agreement as at the Termination Date or such later date as the assets and rights can be realised; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

[406] The percentage must be agreed between the Parties at the Signature Date.

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(i) *agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and*

(ii) *agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms; and*

(f) *amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off)**;***

*"**Adjusted Highest Tender Price**" means the Highest Tender Price*

***less**, to the extent it is positive amount, the aggregate of:*

(a) *any Post Termination Service Amounts earned by the Private Party to date;*

(b) *the Tender Costs; and*

(c) *amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off),*

***plus** the aggregate of:*

(i) *all credit balances on any bank accounts held by or on behalf of the Private Party on the date that the highest-priced Tender is received; and*

(ii) *any insurance proceeds and other amounts owing to the Private Party (and which the Private Party is entitled to retain), to the extent not included in (i);*

,

to the extent that:

(aa) *(i) and (ii) have not been directly taken into account in that Tender; and*

(bb) *the Institution is entitled to such amounts in accordance with this PPP Agreement;*

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*"**Compensation Date**" means either:*

(a) if Clause [x] (Retendering Procedure) applies, the earlier of:

(i) the date that the New PPP Agreement is entered into; and

(ii) the date on which the Institution pays the Adjusted Highest Tender Price or the Adjusted Debt, as the case may be, to the Private Party, or

(b) if Clause [x] (No Retendering Procedure) applies, the date that the Adjusted Estimated Project Value of this PPP Agreement has been agreed or determined.

*"**Highest Tender Price**" means the price offered by the Tenderer (if any) with the highest tender price*[407] *and, if no Tenders are received, zero;*

*"**New PPP Agreement**" means a contract on the same terms and conditions*[408] *as this PPP Agreement*[409] *at the Termination Date, but with the following amendments:*

(a) if this PPP Agreement is terminated prior to the Service Commencement Date, then the Scheduled Service Commencement Date shall be extended by a period to allow the New Private Party[410] *to achieve Service Commencement on or before the extended Scheduled Service Commencement Date;*

(b) any accrued Penalty Deductions and/or warning notices shall be cancelled;

(c) the term of such contract shall be a period equal to the period from the [Termination Date][411] *until the Expiry Date; and*

[407] The tender price must be bid as a lump-sum. If this were not the case then the Institution would have to fund the delay in payment of the compensation amount which is unlikely to represent value for money.

[408] The New Private Party will take over from the Private Party as counterparty under the PPP Agreement and therefore take on all existing and antecedent liabilities (except in respect of Penalty Deductions for the purposes of termination and warning notices). Any bidder will therefore conduct extensive due diligence on the Project for the purposes of correctly pricing its bid.

[409] This should also include other documents entered into between the Parties, where appropriate.

[410] That is, time to complete is given if termination occurs prior to Service Commencement. If termination occurs during the construction period or rectification work is required following termination, but while the New PPP Agreement is in effect, then the remaining Service Period under the New PPP Agreement may be shorter than the unexpired Service Period under the existing PPP Agreement.

[411] Where the Institution will no longer require the services that make up the Services, on or shortly after the original Expiry Date, then the term of the New PPP Agreement will be reduced.

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(d) any other amendments, which do not adversely affect the Private Party;

*"**New Private Party**" means the person who has entered or who will enter into the New PPP Agreement with the Institution;*

*"**Post Termination Penalty Deduction Amount**" means an amount equal to the Penalty Deductions due in respect of the Services provided by the Private Party for the period from the Termination Date to the Compensation Date,;*[412]

*"**Post Termination Service Amount**"*[413] *means for the purposes of Clause [x] (Retendering Procedure), the User Charges earned by the Private Party for the period from the Termination Date to the Compensation Date, less the aggregate of:*

(a) the Post Termination Penalty Deduction Amount for that period; and

(b) the Rectification Costs incurred by the Institution in that period;

*"**Rectification Costs**" means, for the purposes of any Termination Date that occurs during the Service Period, an amount equal to the reasonable and proper costs incurred by the Institution in ensuring that the Services are available;*[414]

*"**Tender**" means any tender submitted by a Tenderer that meets the qualification criteria notified under Clause [x] (Retendering Procedure);*

*"**Tenderer**" means a tenderer who is a Suitable Substitute Private Party*[415] *having submitted a Tender that complies with the requirements of the Request for Proposal issued by the Institution in relation to the New PPP Agreement;*

*"**Tender Costs**" means the reasonable and proper costs of the Institution incurred in carrying out the Tender Process;*

[412] The costs incurred by the Institution to make available any Services that were unavailable at the Termination Date will be covered under the Rectification Costs. The Rectification Costs themselves are then deducted from the Post Termination Service Amounts.

[413] See the discussion under Section 60.4.5.

[414] That is, in accordance with the output specifications in the existing PPP Agreement.

[415] As defined in the Direct Agreement (see Part O:69 (*Step-in: Standard Direct Agreement*)).

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*"**Tender Process**" means the process by which the Institution requests tenders from any parties interested in entering into a New PPP Agreement, evaluates the responses from those interested parties and negotiates the conclusion of a New PPP Agreement with a New Private Party, in accordance with Clause [x] (Retendering Procedure); and*

*"**Tender Process Monitor**" means a third party appointed by the Private Party under Clause [x] (Retendering Procedure).*

Standard Clause

Retendering Procedure

If the Institution elects to retender the provision of the Services under Clause [x] (Retendering Election), then the following provisions shall apply:

(a) The objective of the retendering procedure shall be to establish and (subject to Clause (k)) pay to the Private Party the Adjusted Highest Tender Price, as a result of the Tender Process.

(b) The Institution shall (subject to any legal requirements preventing it from doing so) use its reasonable endeavours to complete the Tender Process as soon as practicable.

(c) The Institution shall notify the Private Party of the qualification criteria and the other requirements and terms of the Tender Process, including the timing of the Tender Process, and shall act reasonably in setting such requirements and terms.

(d) The Private Party authorises the release of any information that is reasonably required as part of the Tender Process by the Institution, which the Institution would otherwise be prevented from releasing under Clause [x] (Confidentiality).

(e) The Private Party may, at its own cost, appoint a Tender Process Monitor for the purposes of monitoring and reporting to the Private Party and the Lenders on the Institution's compliance with the Tender Process and making representations to the Institution. The Tender Process Monitor will not disclose any confidential information[416] to the Private Party, the Lenders or any other person (and shall provide an undertaking to the Institution to such effect as a condition of its appointment) but shall be entitled to advise the Private Party as to whether it considers that the Institution has acted in accordance with the

[416] The Parties will agree what constitutes "confidential information" when the Tender Process Monitor is appointed.

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Tender Process, and correctly determined the Adjusted Highest Tender Price.

(f) The Tender Process Monitor shall be required to enter into a confidentiality agreement with the Institution in a form acceptable to the Institution and shall be entitled to attend all meetings relating to the Tender Process, and inspect copies of the tender documentation and bids, and shall make written representations to the Institution regarding compliance with the Tender Process. The Tender Process Monitor shall be required to make all representations in a timely manner as the Tender Process proceeds. The Institution shall not be bound to consider or act upon such representations but acknowledges that such representations may be referred to by the Private Party in the event that the Private Party refers a dispute relating to the Adjusted Highest Tender Price to dispute resolution in accordance with Clause [x] (Dispute Resolution).

(g) For the period from the Termination Date to the Compensation Date, the Private Party shall upon a request in writing of the Institution continue to provide such Services as can be made available by the Private Party (to the extent required by the Institution) and shall be entitled to bill and collect the related User Charges. The provision of such Services shall remain subject to Performance Deductions, if any, which shall accrue on the basis contemplated in Schedule [x] up to the Compensation Date.

(h) The Institution shall require bidders to bid on the basis that they will receive the benefit of any insurance proceeds or any outstanding claims under material damage insurance policies[417] *on the date that the New PPP Agreement is entered into.*

(i) As soon as practicable after tenders have been received, the Institution shall (acting reasonably) evaluate the Tenders and shall notify the Private Party of the Adjusted Highest Tender Price.

(j) If the Private Party refers a dispute relating to the Adjusted Highest Tender Price to dispute resolution in accordance with

[417] This will be for the purposes of carrying out any reinstatement works.

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Clause [x] (Dispute Resolution), the Institution shall nevertheless be entitled to enter into a New PPP Agreement.[418]

(k) *Within [x] Business Days after the Adjusted Highest Tender Price has been determined, the Institution shall pay (or shall cause the New Private Party to pay) to the Private Party, the greater of:*

(i) *the Adjusted Debt; and*

(ii) *the Adjusted Highest Tender Price.*

(l) *The discharge by the Institution of its payment obligation in Clause (k) above shall be in full and final settlement of all the Private Party's claims and rights against the Institution for breaches and/or termination of this PPP Agreement and the Project Documents*[419] *whether under contract, tort or otherwise, save for any liability of the Institution which arose prior to the Termination Date that has not already been taken into account in determining the Adjusted Highest Tender Price or the Adjusted Debt (as the case may be).*

(m) *Subject to Clauses (n) and (p) below, if the Institution has not paid an amount equal to the Adjusted Highest Tender Price or the Adjusted Debt in terms of Clause (k) to the Private Party on or before the date falling 2 (two) years after the Termination Date then the provisions of this Clause shall not apply to that termination and the provisions of Clause [x] (No Retendering Procedure) shall apply instead.*

(n) *If each of the Adjusted Debt and the Adjusted Highest Tender Price is zero or a negative number then the Institution shall have no obligation to make any payment to the Private Party and with effect from the time that the Institution gives notice of such determination to the Private Party, the Institution shall be released from all liability to the Private Party for breaches and/or termination of this PPP Agreement and any other Project Document whether under contract, tort or otherwise save for any liability of the Institution which arose prior to the Termination Date that has not already been taken into account in determining the Adjusted Highest Tender Price or Adjusted Debt.*

(o) *The Institution may elect at any time prior to the receipt of a Tender to follow the no retendering procedure under Clause [x]*

[418] If there is an agreed amount and a disputed amount then the Institution should only be entitled to retain the disputed amount.

[419] Any other relevant contract should also be included here.

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(No Retendering Procedure) by notifying the Private Party that this election has been made.

(p) *If the Institution receives a Tender but decides not to complete the Tender Process, it shall notify the Private Party of this decision and pay to the Private Party an amount equal to the greater of the Adjusted Highest Tender Price and the Adjusted Debt within [x] Business Days of such notification.*

60.5 No Retendering Procedure

60.5.1 In the event that there is no liquid market or the Institution elects not to retender the PPP Agreement the Adjusted Estimated Project Value should be calculated. Ideally this should be the amount paid to the Private Party in such event. As in the case of retendering, the lack of maturity of the Pakistani PPP market may give rise to concerns on the part of the private sector, especially the Lenders, that the Debt or a significant portion thereof will not be repaid on termination.

60.5.2 In order to address these concerns during these developing stages of the Pakistani PPP market, the prescribed approach in this Standardisation is to compensate the Lenders for a pre-agreed portion of the Debt if the Adjusted Estimated Project Value is less than that pre-agreed percentage of the Debt.

60.5.3 The total Debt outstanding should not be repaid as the termination is due to Private Party Default. The Debt should be reduced in order to determine the level of compensation that the Institution should pay in this event. At the original RFP stage, the Institution must request that the bidders bid on what percentage of the Debt they believe should be repaid in the event that the Adjusted Estimated Project Value is less than the Debt. The Institution must take advice from its financial advisors as to what is appropriately punitive in order to determine the percentage of the Debt that should be repaid in these circumstances. The percentage of the

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Debt that will be repaid must be agreed by the Parties at the Signature Date and incorporated into the PPP Agreement.

60.5.4 If the Adjusted Estimated Project Value is less than the agreed percentage of the Debt, the Institution should pay the Private Party compensation based on the agreed percentage of the Debt instead of compensation based on the Adjusted Estimated Project Value.

60.5.5 Any compensation payable to the Private Party on termination due to Private Party Default should be net of any Post Termination Service Amounts paid to the Private Party, any amounts due to the Institution by the Private Party, the costs associated with the calculation of the estimated project value as well as any Rectification Costs.

60.5.6 In the Unitary Payment PPPs, calculation of the Adjusted Estimated Project Value is based on the forecast of the full Unitary Payment from the date of termination to the Expiry Date (ignoring any Penalty Deductions). That method is premised on that the market or demand risk in Unitary Payment PPPs rests with the Institution. In User Pay PPPs, the market or demand risk is assumed by the Private Party; to compensate the Private Party on the same basis as in Unitary Payment Standardisation (by assuming the Base Case Cash Flow Estimate) would translate in the market or demand risk being retransferred to the Institution if the actual demand risk has remain below the projected level.

The prescribed approach in User Pay PPPs is to take into account the lower of the Base Case Cash Flow Estimate and the Revised Cash Flow Estimate (as these terms are defined in Part A (*Preliminary: Definitions*). The estimated costs to the Institution of delivering the Services to the standard required in the PPP Agreement (including maintenance costs, refurbishment costs and rectification costs) are then deducted. The

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Revised Cash Flow Estimate captures the market or demand risk for the account of the Private Party, by rebasing the estimated cash flows to the actual market or demand in the preceding three years. As the Private Party will commit to the Project in the expectation of earning the Base Case Cash Flow Estimate, compensation on the basis of a higher Revised Cash Flow Estimate (if the demand projections are exceeded) will translate into a windfall for the Private Party and will require the Institution to pay an amount that was not foreseen and therefore not committed by the Institution; the lower Base Case Cash Flow Estimate in that case will constitute adequate, pre-committed return to the Private Party.

60.5.7 The first point to consider is whether this calculation should be conducted in nominal terms (that is, using current prices) or in real terms (that is, using constant prices). For contracts with 100% indexation to CPI it should not normally matter since both methods would achieve the same result. However, the advantages of conducting the analysis in nominal terms are the following:

60.5.7.1 many elements of a project (including tax and cost of funds) are quoted in nominal terms. It is therefore easier to use the same base; and

60.5.7.2 the "real" value of the equivalent User Charges effectively declines with time. The effect of indexation must therefore be recognised by explicitly including the indexation effects and conducting the analysis in nominal terms.

60.5.8 If the forecast cash flows (revised or base case, as determined under Section 60.5.6) are expressed in nominal terms (that is, taking indexation into account), the discount rate used must also be expressed in nominal

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terms. The discount rate is usually made up of a "real" rate of return to which an allowance for inflation is added. A methodology for making this adjustment is set out in the Standard Clause below.

60.5.9 The Institution and the Private Party will need to agree on a forecast rate of inflation to make the nominal calculations. The agreed assumed rate of inflation should be the State Bank's target long-term inflation rate as published by the State Bank.[420]

60.5.10 The Estimated Project Value analysis should be conducted in pre-tax terms.

60.5.11 The forecast cash flows should be discounted at the "Termination Date Discount Rate" (as defined in the Standard Definitions below), which reflects the risk of the underlying cash flow by using the real pre-tax project internal rate of return reflected in the base case Financial Model. Since underlying rates in the market, such as the real yields on government bonds, can and do vary over time, the formula for the Termination Date Discount Rate takes into account the effect of changes to these underlying variables.

60.5.12 The main argument in favour of giving effect in the discount rate to changes in underlying risk-free rates is that if a liquid market existed and the PPP Agreement were successfully retendered, a hypothetical bidder would take into account current market yields on risk-free investments in choosing what discount rate to apply to the Project. If these benchmark rates had moved upwards, for instance, in the time between Signature Date and Termination Date, an incoming bidder would bid a lower sum for the Project and vice versa. Not recognising this difference could

[420] This is a CPI target.

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create a discrepancy between the compensation sums arising out of the Retendering Procedure and the No Retendering Procedure. It is therefore recommended that an adjustment should be made as suggested in the drafting below to reflect the impact on the Termination Date Discount Rate of changes to underlying market rates.

60.5.13 An adjustment as proposed below provides the Private Party with a natural hedge against movements in underlying market rates that may cause losses or profits on broken interest rate hedges on termination. If interest rates move down between the Signature Date and Termination Date, the Private Party would find itself having to pay positive breakage costs on the interest rate swap (if one was put in place at Signature Date). Adjusting the Estimated Project Value discount rate downwards in line with market rate movement would have the effect of generating a larger compensation sum, thereby partially or fully protecting the Private Party against the adverse position on its interest rate swap. Upward movements in interest rates would likewise have the opposite effect, generating profits on the broken hedge but a smaller compensation sum from the Institution.

60.5.14 From the point of view of Institutions, it is also beneficial to consider adjustments as suggested below to the discount rate because, just as the adjustment provides the Private Party with a natural hedge against breakage costs, it provides Institutions with a natural hedge against the cost of funding compensation payments. To illustrate, an upward movement in interest rates would make it more expensive for Institutions to finance a given compensation payment, but the proposed mechanism would adjust the discount rate upward in line with market movement and reduce the amount of compensation to be paid, thereby partly protecting

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the Institution's position. A downward movement in market rates would have the opposite effect.

60.5.15 Any dispute as to the assessed value of the terminated PPP Agreement should be dealt with through the dispute resolution procedure.

60.5.16 If the Adjusted Estimated Project Value is less than the pre-agreed percentage of the Debt, then the Institution should pay the Private Party the pre-agreed percentage of the Debt.

Standard Definitions

*"**Adjusted Estimated Project Value**" means the Estimated Project Value of the PPP Agreement*

***less** the aggregate of:*

(a) the Post Termination Service Amounts earned by the Private Party]

(b) the Calculation Costs; and

(c) amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off),

***plus** the aggregate of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the date that the Estimated Project Value of the PPP Agreement is calculated;[421]*and*

(ii) any insurance proceeds,[422] *and other amounts owing to the Private Party (and which the Private Party is entitled to retain), to the extent not included in (i); and*

to the extent that:

(aa) (i) and (ii) have not been directly taken into account in calculating the Estimated Project Value; and

[421] In reality, on Private Party Default (i) and (ii) are likely to be the same amounts.

[422] This shall exclude the proceeds in terms of any material damage insurance. See **Error! Reference source not found.** (*Insurance*).

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(bb) the Institution has received such amounts in accordance with this PPP Agreement;

*"**Calculation Costs**" means the total of all costs forecast to be incurred by the Institution as a result of termination, which shall be calculated and discounted at the Termination Date Discount Rate and deducted from the payment calculated pursuant to sub-Clause (b) in the definition of Adjusted Estimated Project Value above, such costs to include (without double counting):*

(a) a reasonable risk assessment of any cost overruns that will arise,[423] whether or not forecast in the relevant base case;

(b) the costs of the Services forecast to be incurred by the Institution to the standard required[424]; and

(c) any rectification costs required to deliver the Services to the standard required (including any costs forecast to be incurred by the Institution to complete construction or development work and additional operating costs required to restore operating services standards),

in each case such costs to be forecast at a level that will deliver the Services in accordance with the output specifications;

*"**Deemed New PPP Agreement**" means a contract on the same terms and conditions as this PPP Agreement, as at the Termination Date, but with the following amendments:*

(a) if this PPP Agreement is terminated prior to the Service Commencement Date, then the Service Commencement Date shall be extended by a period to allow a New Private Party[425] to achieve Service Commencement;

(b) any accrued Penalty Deductions shall be cancelled; and

[423] A methodology can be agreed in advance for agreeing what constitutes a reasonable risk assessment.

[424] This includes both the everyday running costs and the costs of the service and life-cycle maintenance costs. Forecasts are determined by agreement or, in the event of disputes, by an expert. See Section 63 (*Termination Calculation Expert*).

[425] That is, time to complete is given if termination occurs prior to Service Commencement. Other timing-related issues may require similar treatment depending on the PPP Agreement.

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(c) the term of such contract shall be for a period equal to the term from the Termination Date[426] to the Expiry Date;

*"**Estimated Project Value**" means the amount determined in accordance with Clause [x] (No Retendering Procedure) that a third party would pay to the Institution as the market value of the Deemed New PPP Agreement;*

*"**Termination Date Discount Rate**" means a discount rate expressed as:*

[(1+ Real Base Case Project IRR + Bond B – Bond A) (1+ i) – 1]*

where:

> *"**i**" is the agreed assumed forecast rate of increase in the State Bank's prevailing long-term inflation target;*
>
> *"**Bond A**" is the real yield to maturity on a benchmark government bond instrument of the same or closest possible maturity as the average life of the Debt as at the Signature Date;*
>
> *"**Bond B**" is the real yield to maturity on a benchmark government bond instrument of the same or closest possible maturity as the average life of the Debt as at the Termination Date; and*
>
> *"**Real Base Case Project IRR**" means the real pre-tax Project internal rate of return[427] as set out in the Financial Model.[428]*

[426] The Termination Date here is the relevant date as no New PPP Agreement is actually being entered into.

[427] This is the Shareholders' pre-tax return. This is calculated after any taxes due by the Private Party have been deducted.

[428] Parties should not agree on a discount rate other than this (this is the discount rate contained in the Financial Model).

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Standard Clause

No Retendering Procedure

If either the Institution is not entitled to retender pursuant to Clause [x] (Retendering Election) or the Institution elects to require an expert determination by the Termination Calculation Expert[429] *in accordance with this Clause [x] (No Retendering Procedure) then the following procedure shall apply:*

(a) *Subject to Clause (x)*[430]*, the Private Party shall remain entitled to receive any Post Termination Service Amount.*

(b) *In determining the Adjusted Estimated Project Value the Parties shall procure that the Termination Calculation Expert will be obliged to follow the principles set out below:*

(i) *all forecast amounts should be calculated in nominal terms at current prices, recognising the adjustment for [CPI] in respect of forecast inflation between the date of calculation and the forecast payment date(s) as set out in this PPP Agreement; and*

(ii) *the Revised Cash Flow Estimate (without Penalty Deductions) shall be calculated, and the lower of the Revised Cash Flow Estimate and the Base Case Cash Flow Estimate shall be adopted and discounted to the Termination Date at the Termination Date Discount Rate.*

(c) *If the Parties cannot agree on the Adjusted Estimated Project Value on or before the date falling 30 (thirty) days after the date on which the Termination Calculation Expert has determined such value, in accordance with this Clause [x] (No Retendering Procedure), then the Estimated Project Value shall be determined in accordance with Clause [x] (Dispute Resolution).*

(d) *The Institution shall pay to the Private Party an amount equal to the greater of the Adjusted Debt and the Adjusted Estimated Project Value on the date falling [x] days after the date on which the Adjusted Estimated Project Value has been agreed or determined in accordance with this Clause [x] (No Retendering Procedure).*

[429] See Section 63 (*Termination Calculation Expert*) for a definition.

[430] This refers to the Standard Clause where the provision of post-termination Services is subject to a request in writing of the Institution: see Standard Clause under Retendering Procedure.

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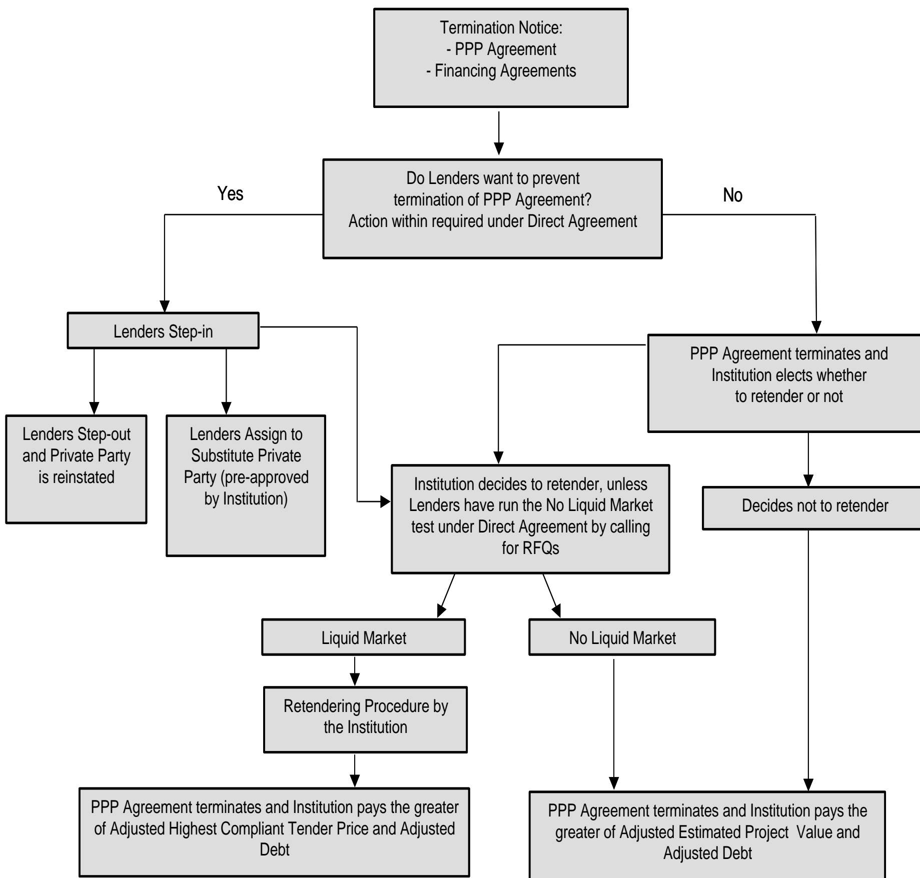
(e) The discharge by the Institution of its obligation in Clause (d) shall be in full and final settlement of all the Private Party's claims and rights against the Institution for breaches and/or termination of this PPP Agreement or any Project Documents whether in contract, delict, restitution or otherwise save for any liability that arose prior to the Termination Date (but not from the termination itself) that has not been taken into account in determining the Adjusted Estimated Project Value.

PRIVATE PARTY DEFAULT



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61 COMPENSATION ON TERMINATION FOR FORCE MAJEURE

61.1 Force Majeure events are events that occur through no fault of either Party. Accordingly, the compensation payable on termination as a result of Force Majeure should reflect the no-fault principle with the consequences of an event of Force Majeure being shared by the Parties. This would mean that the compensation payable in the event of Force Majeure termination should be somewhere between the compensation payable on termination for Institution Default and the compensation payable on Private Party Default.

61.2 On payment of compensation in the event of Force Majeure termination, the Institution should be entitled to deal with the Project Assets (or what remains of them) in any manner it deems feasible.

Standard Clause

Compensation on Termination for Force Majeure

On termination of this PPP Agreement under Clause [x] (Termination for Force Majeure), the Institution shall pay to the Private Party the aggregate of:

(a) an amount equal to the Debt and all fees, costs, expenses, breakage costs and breakage premiums in connection with any Financing Agreement;

(b) the Subcontractor Costs;

(c) an amount equal to the Shareholder Loans less any interest on the Shareholder Loans already paid to the Shareholders;

(d) an amount equal to all amounts paid to the Private Party in respect of Equity less dividends and other distributions already paid to the Shareholders; and

(e) redundancy payments for employees of the Private Party not transferring to the Institution that have been or will be reasonably incurred by the Private Party as a direct result of the termination of this PPP Agreement;

***less**, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

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(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date and the value of any right of the Private Party or the Lenders to receive insurance proceeds or any proceeds pursuant to letters of credit and of any such proceeds actually received by them (save where such credit balances or proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;

(ii) all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities of the Private Party or the Lenders properly incurred in connection with this PPP Agreement; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(aa) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and

(bb) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms; and

(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

If the aggregate of the amounts referred to above is less than zero, then, for the purposes of the calculation in this Clause the aggregate shall be deemed to be zero.

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62 COMPENSATION ON TERMINATION FOR CORRUPT ACTS

62.1 If the Institution wants the right to terminate the PPP Agreement for Corrupt Acts,[431] then it should accept an obligation to pay compensation equal to the Debt, unless the Corrupt Act is attributable to a Lender.

62.2 The exclusion of the Debt in cases where a Lender commits the Corrupt Act should be acceptable to the Lenders, as the remaining Lenders will first have the opportunity to avoid the termination of the PPP Agreement by terminating the involvement of the Corrupt Lender in the financing arrangements for the Project.[432]

62.3 The exclusion of the Equity and the Shareholder Loans should be acceptable to the Shareholders where a Shareholder commits the Corrupt Act. It should also be acceptable to the Shareholders where the Corrupt Act is committed by the Private Party since the Shareholders must accept the risks associated with their relationship to the Private Party, which is reflected in their expectations of a greater return.

62.4 This approach should also be acceptable where the Corrupt Act is committed by a Subcontractor or an employee of a Shareholder, the Private Party or a Subcontractor acting of its or his or her own accord, as the Private Party and the Shareholders will first have the opportunity to replace the offending Subcontractor or employee and thereby avoid the termination of the PPP Agreement.

62.5 On termination of the PPP Agreement as a result of Corrupt Acts, the Institution's only obligation should be to pay the compensation, if any, and, in

[431] See also Section 55.5 (*Termination for Corrupt Acts*).

[432] The Corrupt Lender's involvement in the financing arrangements for the Project must be terminated in all respects, including for instance in the security arrangements for the Project or (if applicable) as the Lenders' Agent. This will also entail that the remaining Lenders take up the Corrupt Lender's share of any undrawn financial commitments and the Debt or, if and to the extent they are unable to do so, assign such commitments and Debt to other Qualifying Financial Institutions.

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addition, it should retain the right to deal with the Project Assets as it deems fit.

Standard Clause

Compensation on Termination for Corrupt Acts

(a) On termination of this PPP Agreement in accordance with Clause [x] (Termination for Corrupt Acts), the Institution shall, subject to Clause (b), pay the Private Party an amount equal to:

the Debt;

***less**, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date and the value of any right of the Private Party or its Lenders to receive insurance proceeds and of any such proceeds actually received by them (save where such credit balances or insurance proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from Subcontractors and any other third parties;

(ii) all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities of the Private Party or the Lenders properly incurred in connection with this PPP Agreement; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(aa) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and

(bb) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms; and

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(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

If the aggregate of the amounts referred to above is less than zero, then, for the purposes of the calculation in this Clause the aggregate shall be deemed to be zero.

(b) If the termination is as a result of a Corrupt Act on the part of any of the Lenders, then the amount payable by the Institution shall be zero.

63 TERMINATION CALCULATION EXPERT

63.1 If any forecast or calculation is required to be made for the purposes of determining an amount payable by one Party to the other pursuant to Section 58 (*Compensation on Termination*) to Section 622 (*Compensation on Termination for Corrupt Acts*) it should be made by a recognised firm of accountants or other independent experts (the "**Termination Calculation Expert**") appointed by the Parties, or in the absence of agreement, by an independent and willing expert third party such as the President of the Institute of Chartered Accountants of Pakistan.[433]

63.2 Each forecast or calculation to be made by the Termination Calculation Expert should be made in accordance with prevailing best market practice. In preparing any forecast or calculation the Termination Calculation Expert will:[434]

63.2.1 be entitled to amend the input parameters contained in the Financial Model to the extent that the Termination Calculation Expert, acting reasonably and having taken appropriate specialist and technical advice from a panel of persons having practical experience in the requisite field, considers that such input parameters do not properly reflect the most likely outcome for the matters which are the subject of such input parameters; and

[433] At the Signature Date, the Parties must agree the procedure for the selection and appointment of the expert as well as the terms of reference for the expert and who will be liable for payment of the expert's fee.

[434] See Section 60.5 (*No Retendering Procedure*).

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63.2.2 otherwise utilise the methodology employed in the Financial Model.

64 AUTHORISATION OF PAYMENTS

Institutions must obtain legal advice as to whether these compensation payments are covered by their constituting statutes or other laws applicable to them. Whatever this advice may be, Private Parties and their funders may prefer to have the necessary authorisations given as if these payments do fall within that chapter. See Part H:37 (*Payment and Financial Matters: Unitary Payments*).

65 PAYMENT PROCEDURE

65.1 Where an incoming Private Party pays market value on Private Party Default termination, or the PPP Agreement is terminated for Institution Default, the Institution should pay the Private Party by way of a lump-sum.

65.2 On other types of termination, the PPP Agreement should deal with how compensation is paid. Value for money issues should be taken into consideration, which in most cases will mean that compensation payments by lump-sum will be the appropriate position. Value for money is unlikely to be achieved if the Institution repays such amounts over time (that is, in instalments), as interest will continue to accrue on the compensation amount so as to reflect the Shareholders' and Lenders' loss of opportunity.

65.3 While the above is the general position, the Institution may wish to reserve the option to pay over a period of time due to affordability constraints. In such event, the following will apply:

65.3.1 The Private Party will require the Institution to pay interest on any outstanding balance. The interest rate must be agreed by the Parties on termination, provided that the Institution should not agree to a rate that is higher than the non-default interest rate under the Financing Agreements. If Equity or Shareholder Loan compensation is also payable on

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termination, the prescribed approach is for the Institution's right to pay by instalments to be restricted to the Debt-related compensation.

65.3.2 If the PPP Agreement is terminated for Private Party Default and the Adjusted Estimated Project Value is payable to the Private Party as compensation, the appropriate interest rate payable on the outstanding balance should again not be higher than the non-default interest rate under the Financing Agreements.[435]

65.3.3 If the Institution elects to pay compensation in instalments that mirror the repayment schedule under the Financing Agreements, both in terms of scheduling as well as amounts, the protections in the PPP Agreement in respect of payment default and unauthorised transfer of the PPP Agreement by the Institution should continue to operate. However, the Private Party should only have the ability to declare all outstanding instalments immediately due and payable on the occurrence of these events. If the Institution elects to pay compensation in instalments, the Lenders should not require the Institution to enter into new funding arrangements.

66 OTHER RIGHTS AND REMEDIES

No Party will have any rights or remedies against any other Party arising on termination save for the rights and remedies specified in the PPP Agreement. The Lenders will obtain benefits that should be specified in a Direct Agreement.

[435] Although the Adjusted Estimated Project Value may be greater than amounts owing to the Lenders, the PPP Agreement will have terminated for reasons that the Private Party can control. In such circumstances, it is equitable for the Shareholders to accept that, to the extent that the Adjusted Estimated Project Value is greater than the outstanding Debt, interest will accrue on all outstanding amounts at the non-default interest rate under the Financing Agreements.

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PART O: STEP-IN

67 BY INSTITUTION

67.1 Introduction

67.1.1 The Institution may want the right to take urgent action in respect of the Services to avert a serious threat to an essential public concern (such as public health, safety of persons and/or property, national security or the environment) or to discharge a statutory duty. The need for this right may be due to matters outside the Project or due to a breach by the Private Party of its obligations under the PPP Agreement.

67.1.2 This right is commonly referred to as "step-in" as it involves the Institution taking over some or all of the Private Party's obligations for a period. Institution step-in, however, is not comparable to Lenders' step-in, which is usually achieved through a separate "Direct Agreement" among the Institution, the Private Party and the Lenders. This is because the Institution step-in is a narrowly tailored remedy involving the Institution stepping-in for a short period to resolve an urgent problem and, upon resolution thereof to its satisfaction, "stepping-out". If the problem in question entails a long-term indefinite step-in with a possibility of no step-out, then the appropriate remedy for the problem is not step-in, but termination.

67.1.3 The period of the step-in will depend on the circumstances necessitating it. Typically though, the period might last a few hours, several days or even a few weeks.

67.1.4 Institution step-in is not appropriate for every PPP. It is only appropriate in relation to projects involving or impacting on essential core Institution services (such as a hospital project, a road transport project or a prison

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project), and then only to the extent that a failure to step-in may seriously threaten an essential public concern or result in a material breach of a statutory duty.

67.1.5 Further, Institution step-in should be in the sole and absolute discretion of the Institution. The Institution should never be obligated to do so.

67.2 Step-in without Private Party Breach

67.2.1 If the need for Institution step-in does not arise because of a breach by the Private Party of its obligations to deliver the Project Deliverables, then the Private Party should be relieved from the performance of those obligations in respect of which step-in is sought.

67.2.2 Further, the Institution should pay for those Project Deliverables in respect of which step-in is sought as if they had been fully available and performed by the Private Party; provided that the Private Party should not be relieved from performing any Project Deliverables that are unaffected by the Institution step-in. Accordingly, if the Private Party fails to perform any Project Deliverables that are unaffected by the Institution step-in, then Penalty Deductions should be made in respect of any such failure.

67.2.3 If, however, the Institution step-in is effected in a manner which interrupts the ability of the Private Party to perform any part of the Project Deliverables that are not included in the Institution step-in, then the Institution should be responsible to make full payment in respect of the interrupted Project Deliverables as the Private Party will be unable to bill and charge the User Charges for the interrupted Project Deliverables.

67.2.4 In addition, the Institution should indemnify the Private Party to the extent that the Private Party suffers any direct losses as a result of the

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Institution carrying out the step-in in a way that does not meet with the standards of Good Industry Practice. The liability of the Institution under this indemnity should be subject to the limitations in Part C:10 (*General Obligations: Double Recovery and Mitigation*).

67.3 Step-in on Private Party Breach

67.3.1 If a breach by the Private Party of its obligations under the PPP Agreement gives rise to any of the circumstances described in Section 67.1.1 and the need for Institution step-in, then the Institution step-in should be at the expense of the Private Party and the Institution should be permitted to do this without giving the Private Party the opportunity to remedy the breach, although the Institution must notify the Private Party of the breach.

67.3.2 Here, the Institution should not have the obligation to make payments to the Private Party in respect of the Project Deliverables that are affected by the breach. The Private Party will continue to enjoy the right to bill and collect User Charges in respect of Project Deliverables not interrupted by Institution step-in, *less* any reimbursements for any costs incurred by the Institution in stepping-in in such circumstances (such costs should extend to the cost of the work, the cost of appointing third parties to perform the work, and the time spent in relation to the step-in). If the Private Party breach also gives rise to losses for which the Institution is indemnified (for example, death or personal injury, loss of or damage to property, and so forth) then the Institution should also seek recovery under those indemnities.

67.3.3 If the breach amounts to a Private Party Default and persists after the Institution has stepped-out, then the Institution should be entitled to terminate the PPP Agreement for Private Party Default, subject to the provisions of the PPP Agreement regarding termination (including any

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remedy period) and the rights of the Lenders under the Direct Agreement. Given that Penalty Deductions may start accruing as a result of the Private Party Default, and given the impact of this on debt service, the PPP Agreement should also compel the Institution to trigger the Private Party Default regime (including the remedy procedures) by the expiry of the step-in period specified in the notice if the Private Party Default persists.

67.4 Access

The Institution must ensure that the PPP Agreement makes adequate provision for any access the Institution may need to the Project Site and the Facilities in exercising its step-in rights.

Standard Clause

Institution Step-in

(a) If the Institution reasonably believes that it needs to take any action in connection with the Project Deliverables because a serious and urgent risk arises [to the health or safety of persons or property, or to the environment, or to national security] and/or to discharge a statutory duty, then the Institution shall be entitled to take action in accordance with the following provisions.

(b) If pursuant to Clause (a) the Institution wishes to take action, it shall as soon as possible after reaching its determination to do so notify the Private Party in writing of:

(i) the action it wishes to take;

(ii) its reasons for taking such action;

(iii) the date when it wishes to commence such action;

*(iv) the time period (the "**Step-in Period**") which it reasonably believes will be necessary for such action and which must be a fixed period; and*

(v) to the extent practicable, the effect of such action on the Private Party and its obligations to perform the Project Deliverables during the Step-in Period.

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*(c) Following the service of such notice, the Institution shall take such action as notified under Clause (b) and any ancillary action as it reasonably believes is necessary (the "**Necessary Action**") and the Private Party shall give all reasonable assistance to the Institution in the conduct of such Necessary Action.*

(d) If the Private Party is not in breach of any of its obligations under this PPP Agreement in respect of which the Necessary Action is proposed to be taken, then for so long as and to the extent that the Necessary Action is taken, and this prevents the Private Party from providing any part of the Project Deliverables:

(i) the Private Party shall be relieved from such obligations; and

(ii) in respect of the time period over which such Necessary Action is conducted and provided that the Private Party provides the Institution with such reasonable assistance as the Institution may need in the conduct of such Necessary Action (such assistance, however, to be at the expense of the Institution to the extent of any incremental costs), the Institution shall make payments to the Private Party equal to the amount the Private Party would have received if it was satisfying all its obligations affected by the Necessary Action in full over such period[436].

(e) If the Necessary Action is taken as a result of a breach by the Private Party of any of its obligations under this PPP Agreement, then for so long as and to the extent that such Necessary Action is taken and this prevents the Private Party from performing any of its obligations:

(i) the Private Party shall be relieved from such obligations; and

(ii) in respect of the period in which the Institution is taking such Necessary Action, the Institution shall not be required to make any payment to the Private Party in relation to the Services disrupted as a result of the Necessary Action; provided, the Private Party shall remain obliged to perform the obligations not affected by the Necessary Action in full over such period, and Penalty Deductions shall continue to accrue in respect of all Services affected by the breach as calculated in accordance with the payment mechanism in this PPP Agreement; provided, further that, the Private Party shall reimburse the Institution an amount equal to the Institution's costs of taking such Necessary Action;

provided that, if by the expiry of the Step-in Period, the breach still subsists and if it constitutes a Private Party Default, then the Institution must serve a notice in terms of Clause [x] (Institution's Options)

[436] Given that usage of the Services and the corresponding User Charges during the Institution Step-in period cannot be predicted with 100% accuracy, these will be best estimates only. The parties can agree on the Signature Date how such estimates will be calculated. These may the usage volumes in the month preceding the Institution Step-in, the usage in the corresponding month in the preceding year in case of seasonal variations, or another such objective criterion.

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requiring the Private Party to remedy the Private Party Default or to put forward a remediation programme.[437]

68 BY THE LENDERS

68.1 Introduction

68.1.1 The main purpose of the Lenders' step-in is to ensure the continuity of the Project if the Private Party defaults under the PPP Agreement or the Financing Agreements.[438] The concern of the Lenders here is that they have financed the Project in reliance primarily on the cash flows attributable to User Charges under the PPP Agreement and thus, if the PPP Agreement is terminated for Private Party Default, their security (typically, cessions and security over the bank accounts of the Private Party, the Project Documents and certain other Project Assets (excluding the Institution Assets)) will be insufficient to service the Debt.

68.1.2 The Lenders will not have any security interest in the Institution Assets. Depending on the Institution's own requirements, the Lenders may not have security over all or even a substantial portion of the remaining Project Assets.[439] Although the Lenders will often seek corporate guarantees or some other support from the Shareholders or their Affiliates, this support will often be restricted to narrow circumstances or limited to the early phases of the Project when capital expenditure needs and the Project risks are greater.

68.1.3 Accordingly, if the Private Party defaults under the PPP Agreement (thereby triggering a cross-default under the Financing Agreements) or if the Private Party defaults under the Financing Agreements and the

[437] The cross-reference is to Clause (b)(ii) of the Standard Clause (*Institution's Options*) in Part N:55.3.3 (*Termination: Termination for Private Party Default*).

[438] Typically, the Financing Agreements will include a "cross-default" provision pursuant to which a Private Party Default will trigger a default under the Financing Agreements.

[439] See Part G: 36 (*Project Assets: Security Over Project Assets*).

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repayment of the Debt is accelerated, the Lenders' security may be insufficient to recover the Debt in full. In light of this, the Lenders will typically seek the Institution's agreement to the continuation of the Project (at the Lenders' election) if such a default occurs.

68.2 Direct Agreement

68.2.1 A "**Direct Agreement**" as referred to in this Standardisation is an agreement among the Institution, the Lenders (usually represented by an agent) and the Private Party, which creates a mechanism for the continuation of the Project following a threatened termination of the PPP Agreement and the Financing Agreements.

68.2.2 In simple terms, the advantage of a Direct Agreement for the Institution is the continuity of the Project Deliverables and, for the Lenders, the continuity of the cash flows of the Project that are required to service the Debt.

68.2.3 The key issues are:

68.2.3.1 when the Lenders should be permitted to step-in;

68.2.3.2 the extent to which the Lenders should be obliged to assume liabilities of the Private Party; and

68.2.3.3 the extent to which the Lenders will be given the opportunity to rectify Private Party Defaults.

68.3 Prescribed Approach

68.3.1 The prescribed approach to the step-in rights of the Lenders is based on the following main principles:

68.3.1.1 the Lenders' step-in is voluntary;

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68.3.1.2 the Institution must be no "worse off" under the step-in arrangements, that is, the PPP Agreement must continue to be performed in accordance with its terms (including, without limitation, those provisions relating to the accrual of Penalty Deductions save as provided in Section 68.4 (*Accrual of Penalty Deductions*)) as if the Private Party was performing under the PPP Agreement;

68.3.1.3 the Lenders' election to step-in may only be exercised after the Institution has informed the Lenders of all outstanding liabilities due and payable by the Private Party to the Institution and all Private Party Defaults that must be remedied;

68.3.1.4 the Lenders may only exercise their step-in rights upon payment of all such liabilities to the Institution;

68.3.1.5 the Lenders must provide and implement, during an agreed step-in period, a remedial programme, reasonably satisfactory to the Institution, setting forth the proposed remedies in respect of the Private Party Defaults triggering the step-in, details of the person(s) nominated by the Lenders to undertake the remediation (the "**Appointed Representative**"), and a detailed timeline specifying all phases up to the completion of the remediation;

68.3.1.6 during the step-in period the Lenders (and their Appointed Representative) incur no liability;[440]

68.3.1.7 if the Private Party Default which triggered the step-in is remedied in accordance with the remedial programme and within the timeline set forth in it, then the Lenders have the option to step-out (and the Private Party must resume full performance of the Project

[440] The outstanding liabilities referred to in Section 68.3.1.3 must be discharged before step-in.

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Deliverables), or to substitute the Private Party with another entity (a "**Substitute Private Party**");

68.3.1.8 if the Lenders wish to assign the PPP Agreement to a Substitute Private Party, then the selection of the Substitute Private Party must be made by the Lenders with the prior written approval (not to be unreasonably withheld) of the Institution applying the same qualification criteria that were applied by the Institution in awarding the bid to the Private Party;

68.3.1.9 until the PPP Agreement is assigned to the Substitute Private Party, the original Private Party must remain liable under the PPP Agreement; and

68.3.1.10 if the Private Party Default triggering the step-in is not remedied in accordance with the agreed remedial programme and timeline, or any new Private Party Default occurs during the step-in period, then the Institution must be entitled to terminate the PPP Agreement in accordance with the Retendering Procedure or No Retendering Procedure (see Part N:60 (*Termination: Compensation on Termination for Private Party Default*)). However, the Institution should not have the option to retender if the No Liquid Market Test (see Clause 4 of the Standard Direct Agreement) is satisfied, that is, less than three bidders have pre-qualified.

68.3.2 The advantages of this approach for the Lenders are that they are informed of the outstanding liabilities of the Private Party which they are required to assume *before* exercising their election to step-in, they can step-out at any time and they incur no liabilities as a result of stepping-out.

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68.3.3 In turn, the Institution retains the right to terminate if any new Private Party Default occurs or if the remedies are not being carried out in accordance with the agreed remedial programme. Thus the Private Party remains liable and any further losses (including rectification costs) incurred by the Institution during the step-in period or as a result of the Lenders stepping-out will be reflected in the compensation (whether pursuant to the Retendering Procedure or the No Retendering Procedure) payable on Private Party Default.[441]

68.4 Accrual of Penalty Deductions

68.4.1 As previously indicated, the step-in by the Lenders should not interrupt the ordinary running of the PPP Agreement, including the accrual of Penalty Deductions, save for the purpose of triggering termination. Stated differently, the accrual of Penalty Deductions should be suspended over the step-in period in relation to the Institution's rights to terminate the PPP Agreement, but not in relation to the Institution's rights to make Penalty Deductions.

68.4.2 The reason for this is that the Private Party should not benefit from its breach by being relieved of its obligation under the PPP Agreement to make the Services available according to the output specifications. The Penalty Deductions should reflect the loss to the Institution and/or the end users caused by the Private Party Default which triggered the step-in, and, therefore, the Institution should not be entitled to terminate the PPP Agreement – provided, however, that the Lenders are using reasonable endeavours to ensure that the remedial programme is being implemented in the step-in period.

[441] In this regard see **Error! Reference source not found.** (*Termination*).

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68.4.3 If the Lenders step-out, the suspension of the accrual of Penalty Deductions for termination purposes should be lifted. If the step-in period ends because the Private Party has been substituted, then all accrued Penalty Deductions exceeding the value of the Performance Security posted by the original Private Party should be cancelled as against the Substitute Private Party for all purposes (not limited to termination), otherwise the Substitute Private Party will not be incentivised to take over the PPP Agreement. The accrued Penalty Deductions exceeding the Performance Security posted by the original Private Party will be set off against the compensation payable by the Institution on termination to the Private Party. The Substitute Private Party should be required to post a fresh Performance Security on taking over the Project.

68.4.4 The Direct Agreement used here does not grant the Institution a right to recover against the Lenders damages caused in connection with the exercise by them of their step-in rights. This is because the PPP Agreement should provide for such damages to be claimed, where the PPP Agreement is not terminated, by the Institution directly from the Private Party or, where the PPP Agreement is terminated, to be captured in the calculation of the termination compensation.

68.4.5 If the step-in occurs prior to the Service Commencement Date and during the construction or development phase of the Project, the Institution should recover its losses for non-delivery of the relevant Works from the security held by it in respect of the construction or development works. In this regard, see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*).

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68.5 Refinancing

It is possible that the Project may need to be "rescued" through a Refinancing, for instance, by way of additional capital such as an increased Debt commitment in the step-in period (or thereafter if the Private Party has been substituted). Any such "rescue" Refinancing must be subject to prior written approval of the Institution.[442]

69 STANDARD DIRECT AGREEMENT[443]

*THIS DIRECT AGREEMENT[444] (this "**Direct Agreement**") IS MADE ON [date] AT, [place],*

AMONG

*(1) [RELEVANT INSTITUTION] (the "**Institution**");*

*(2) [x] (the "**Agent**" for the Lenders); and*

*(3) [x] (the "**Private Party**").*

IT IS AGREED AS FOLLOWS:

1 DEFINITIONS AND INTERPRETATION

(a) <u>Definitions</u>

In this Direct Agreement, unless the context otherwise requires:

*"**Affiliate**" has the meaning in the PPP Agreement;*

*"**Agent**" means the agent appointed by the Lenders and notified in writing to the Institution;*

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[442] See **Error! Reference source not found.** (*Refinancing*).

[443] This Direct Agreement covers the step-in and substitution regime. Other issues may need to be dealt with, for example, the sharing of security between the Lenders and the Institution, the administration of payments from the Joint Insurance Account, the economic test for reinstatement following an insured event under the material damage policies and so forth.

[444] The Institution's prescribed form of Direct Agreement should be submitted to the Approval Authority when (along with the prescribed form of PPP Agreement and other procurement documentation) the corresponding Approvals of the Approving Authority are applied for. The final Agreed Form of the Direct Agreement should be settled when the PPP Agreement is settled and should be submitted to the Approval Authority when the corresponding Approval is applied for.

If an Institution is approached after its receipt of the Approval by the Private Party or the Lenders to consider any amendments to the Direct Agreement (or Agreed Form thereof), then the Institution should first seek approval from the Approval Authority for such amendments. That approval will only be granted if the amendments will not have a materially adverse impact on the value for money, affordability and risk transfer requirements of the Project.

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*"**Appointed Representative**" has the meaning in Clause 5(a);*

*["**Credit Agreement**" means the [contract description], dated [x], among the Private Party, the Agent and the Lenders;]*[445]

*"**Debt**" has the meaning in the PPP Agreement;*

*"**Enforcement Event**" means any acceleration of the Debt (following an event of default under the Credit Agreement) and/or the commencement of any enforcement procedure under the Security Documents, as notified by the Agent to the Institution, which notice shall describe the event of default in respect of which such acceleration and/or enforcement is carried out;*

*"**No Liquid Market**" means that less than 3 (three) parties meeting the criteria in (a), (b) and (c) of the definition of "Substitute Private Party" have pre-qualified pursuant to a request in Clause 4(a)(i);*

*"**Notice of Existing Liabilities**" has the meaning in Clause 3(b);*

*"**Penalty Deductions**" has the meaning in the PPP Agreement;*

*"**PPP Agreement**" means the public private partnership agreement, dated [x], between the Institution and the Private Party;*

*"**Pre-termination Notice**" has the meaning in Clause 3(a);*

*"**Private Party Default**" means any Private Party Default (as defined in the PPP Agreement) that is capable of being remedied, being any Private Party Default referred to in Clause [x] (Institution's Options) of the PPP Agreement;*[446]

*"**Project Deliverables**" has the meaning in the PPP Agreement;*

*"**Required Period**" means*[447] *the period starting on the date of a Pre-termination Notice and: (a) during the period preceding the Service Period, ending [120 (one hundred and twenty)] days later; and (b) during the Service Period, ending [90 (ninety)] days later;*

*"**Service Period**" has the meaning in the PPP Agreement;*

*"**Security Documents**" means the documents creating or evidencing the security granted by the Private Party to the Lenders (or any*

[445] This should be the loan facility, credit or common terms agreement(s) included in the Financing Agreements as defined in the PPP Agreement.

[446] This is a reference to sub-Clause (b) (ii) of the Standard Clause (*Institution's Options*) in Part N:55.3.3 (*Termination: Termination for Private Party Default*).

[447] The time periods will be subject to the specific requirements of particular projects, but those suggested in this draft Clause are likely to be appropriate for many projects that have a split between the construction phase and the operating phase.

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security company, trust or other entity appointed by them to hold the security) in respect of the Debt;

*"**Step-in Date**" means the date on which the Agent first takes any action under Clause 5(a);*

*"**Step-in Period**" means the period from the Step-in Date up to and including the earlier of: (a) the Step-Out Date; [(b) the date of any assignment under Clause 8 (Assignment of PPP Agreement to the Substitute Private Party);] (c) the date of any termination for breach under Clause 6(b); (d) the date of expiry of the PPP Agreement; and (e) the later of the date falling [one] year after [construction completion] and the date falling [two] years after the Step-in Date;*[448]

*"**Step-out Date**" means the date falling [30 (thirty)]*[449]*days after the date of the notice given under Clause 7 (Step-out); and*

*"**Substitute Private Party**" means a person approved by the Institution as:*[450] *(a) having the appropriate technical and financial ability to perform the rights and obligations of the Private Party under the PPP Agreement; (b) employing persons having the appropriate qualifications, experience and technical competence; and (c) having sufficient resources available to it (including committed financial resources and subcontracts) to perform the obligations of the Private Party under the PPP Agreement.*[451]

(b) Interpretation

[Relevant parts of Part A:2 (Preliminary: Interpretation) of the PPP Agreement should be included here with suitable amendments where necessary].

2 CONSENT TO SECURITY

(a) The Institution acknowledges notice of, and consents to, the security interests granted over the Private Party's rights under the PPP Agreement effected by the Private Party in favour of the Lenders under the Security Documents.[452]

[448] Clause (e) assumes that an indefinite period for step-in is undesirable. The Institution should, however, not be opposed to an indefinite period if step-in does not affect the Project (that is, performance of the Project Deliverables) unduly and if a longer period is appropriate in certain projects. The Parties should be wary of requiring the Lenders to assign the PPP Agreement to a Substitute Private Party simply to end the Step-in Period.

[449] This will depend on the time required by the Institution to put in place alternative measures to provide the Service.

[450] The criteria should at least match the criteria in the RFP for selecting the original Private Party. If an approval from a Responsible Authority is required – such as from a regulatory authority for assignment of the operating licence – then such requirement should be added.

[451] The assignment of the PPP Agreement to a Substitute Private Party should not be necessary if the Project is remedied during the Step-in Period.

[452] The Institution's consent is required by the Lenders (or any security company, trust or other entity established by them to hold the security for the Project) to enforce the security interests in and to the Private Party rights under the PPP Agreement.

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(b) The Institution confirms that it has not received notice of any other security interest granted over the Private Party's rights under the PPP Agreement.[453]

3 NOTICES OF PRE-TERMINATION AND EXISTING LIABILITIES

The Institution shall not terminate the PPP Agreement without giving to the Agent:

*(a) at least the Required Period of prior written notice of the proposed termination (the "**Pre-termination Notice**") stating:*

(i) the proposed termination date; and

(ii) the Private Party Default(s) constituting the grounds for termination in reasonable detail; and

*(b) not later than (A) the date falling [x] days after the date of a Pre-termination Notice or, if earlier, (B) the date falling [x] days after the date on which the Agent notifies the Institution that an Enforcement Event has occurred, a notice (the "**Notice of Existing***

***Liabilities**") containing details of any amounts owing by the Private Party to the Institution under the PPP Agreement:*[454]

(i) which are overdue at the date of the Pre-termination Notice or the date of the Agent's notice, as the case may be; and

(ii) which will fall due at any time in the period from that date to the end of the Required Period.

4 NO LIQUID MARKET

*(a) At any time in the Required Period (and not thereafter) and provided the Lenders have stepped-in, the Agent may issue written notice to the Institution (the "**No Liquid Market Notice**"):*

(i) confirming that the Lenders have issued a request for pre-qualification for the provision of the Project Deliverables for the unexpired portion of the Project Term and that there is No Liquid Market; and

[453] Institutions should undertake such due diligence as is necessary to be able to make this confirmation.

[454] In any Project financed with limited-recourse debt, the Lenders will generally take a very active role in monitoring most aspects of the Project. They will have their own technical advisors to monitor the Private Party's and Subcontractors' performances. They will apply the financial ratios (usually, an annual historical and forecast debt service cover ratio, and a loan life cover ratio) applicable to the Project, usually at six-monthly intervals, to assess whether the cash flow of the Project will meet required debt service. The Lenders will, therefore, be better informed regarding the financial condition of the Project and the Private Party. In such circumstances there is no need for the Institution to conduct an extensive due diligence to establish the unperformed obligations of the Private Party.

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(ii) describing in detail the pre-qualification process undertaken by the Lenders.

*(b) On or before the [10th (tenth)] day (excluding any Saturday, Sunday or public holiday in Pakistan ("**Business Day**")) following the Institution's receipt of the No Liquid Market Notice, the Institution shall issue written notice to the Agent stating whether or not it agrees with the Agent that No Liquid Market exists, and if it disagrees with the Agent, its reasons for such disagreement.*

(c) If the Institution fails to issue a notice as required in Clause 4(b) or the Parties do not agree that No Liquid Market exists, then the Agent must refer the dispute (which shall be deemed to exist if the Institution fails to issue the required notice), for determination in terms of Clause [x] (Fast-track Dispute Resolution) of the PPP Agreement which shall apply to such dispute, mutatis mutandis.

(d) If the parties agree that No Liquid Market exists or it is so determined as aforesaid, then the PPP Agreement shall terminate automatically on the date of such agreement or determination and the provisions of Clause [x] (No Retendering Procedure) of the PPP Agreement shall apply.[455]

(e) If the No Liquid Market Notice is issued in the Required Period and a dispute is referred for determination as contemplated in Clause 4(c), then the Required Period shall be extended by the period over which the dispute is determined.

5 APPOINTED REPRESENTATIVE

(a) Without prejudice to the Agent's rights under the Security Documents, at any time:

(i) during which an Enforcement Event is subsisting (whether or not a Pre-termination Notice has been served); or

(ii) during the Required Period,[456]

*the Agent may, on written notice to the Institution of no less than [5 (five)] Business Days appoint a representative (the "**Appointed***

[455] This determines the amount of compensation payable on termination for Private Party Default if there is no liquid market, that is, the Adjusted Estimated Project Value. See Part N:60 (*Termination: Compensation on Termination for Private Party Default*).

[456] The Institution should ensure that it has reserved in the PPP Agreement the right to enter on the property and restore problems that need urgent attention during this period.

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Representative") *who shall jointly and severally assume all the Private Party's rights to perform all of the Project Deliverables.*[457]

(b) *Such appointment shall take effect on the next Business Day following the expiry of the notice period.*

(c) *Within [10 (ten)] Business Days after the appointment becomes effective, the Agent shall provide the Institution with full details of the remedial programme to be implemented by the Appointed Representative in respect of the Private Party Default(s) mentioned in the Pre-termination Notice (if any).*

6 *STEP-IN PERIOD*

(a) *Without limiting Clause 3 (Notices of Pre-termination and Existing Liabilities), but subject to Clause 6(b), the Institution shall not terminate the PPP Agreement during the Step-in Period on grounds:*

(i) *that the Agent has taken any action referred to in Clause 5 (Appointed Representative) or enforced any Security Document(s); or*

(ii) *arising prior to the Step-in Date of which the Institution is aware*[458] *as at the Step-in Date; or*

(iii) *arising solely in relation to the Private Party,*[459]

unless, in the case of section (ii) above:

(aa) *[the grounds arose during the period preceding the Service Period,*[460] *and Service Commencement does not begin on or before the date falling [x]*[461] *months after the Long Stop Date (as defined in the PPP Agreement); or]*

(bb) *[the grounds arose during the Service Period, and] neither the Appointed Representative nor the Private*

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[457] The Appointed Representative does not assume the Private Party's obligations under the PPP Agreement since the Private Party's continued liability (particularly for ongoing Services) under the PPP Agreement must be preserved as if the PPP Agreement were being performed by the Private Party.

[458] This means that, notwithstanding the discovery after the Step-in Date of a latent defect (in the Facilities constructed or developed by or on behalf of the Private Party) that actually existed prior to the Step-in Date, it should be treated as having arisen after that date. This should not apply to latent defects in the Institution Assets.

[459] For example, insolvency of the Private Party.

[460] This refers to the construction or development phase. It may not always be clear when this phase ends, particularly in a phased construction or development. The key determinant will, of course, be the extent to which failure to complete any construction or development Works will lead to termination (thereby preventing full Service Commencement), in which case Clause (aa) will apply. If the failure is in the delivery of the Services from a completed Facility, then Clause (bb) will apply.

[461] Time periods will depend on a number of issues, including the nature of the Project and the length of the construction or development phase. If there is no critical need for the Project to commence by a certain date (that is, no Long Stop Date) or the Parties believe the financial incentives are sufficiently strong, then Clause (bb) may also apply to terminations in the construction or development phase. In such event, Clause (aa) and the reference in Clause (bb) to when the grounds arose should both be deleted.

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Party is using all reasonable endeavours (including implementation of the remedial programme) to remedy the Private Party Default and that Private Party Default is continuing.

(b) The Institution shall be entitled to terminate the PPP Agreement by written notice to the Private Party (copied to the Agent and the Appointed Representative):

(i) if any amount referred to in Clause 3(b)(i) has not been paid to the Institution on or before the Step-in Date;

(ii) if any amount referred to in Clause 3(b)(ii) has not been paid within [x] Business Days of the due date under the PPP Agreement for that amount;

(iii) if any amount incurred prior to the date of the pre-termination Notice (of which the Institution was not aware (having made reasonable enquiry) at the time), and that is subsequently notified by the Institution to the Agent is not discharged on or before the date falling [30 (thirty)] days after the date of such notice;

(iv) if any of the provisions of (aa) or (bb) of Clause 6(a) apply; or

(v) for any Private Party Default arising after the Step-in Date; provided that any Penalty Deductions that accrued prior to the Step-in Date shall not be taken into account for the purposes of termination, but shall be taken into account for such purposes after the Step-out Date,

in accordance with the terms of the PPP Agreement.[462]

(c) Save as provided in Clause 6(b), the Institution shall deal with the Appointed Representative and not the Private Party during the Step-in Period. The Private Party shall be jointly and severally liable for all actions or omissions of the Appointed Representative, as if these actions and omissions are those of the Private Party.

7. STEP-OUT

(a) The appointment of the Appointed Representative shall cease on the expiry of a period of [30 (thirty)] days following the issue by the

[462] That is, the PPP Agreement without reference to this Direct Agreement and means grounds unrelated to the cause of the Pre-termination Notice for which a remedial programme will have been agreed. This approach is flexible enough so that termination is not inevitable. It allows the Lenders to devote time and resources to remedy the default for which the Pre-termination Notice was given without the threat of a hair-trigger termination. Here Penalty Deductions are not automatically reset to zero although, for the purposes *only* of termination, they cease accruing. Issues here are likely to be project-specific as they require parties to reach a commercial view on the likelihood of further Penalty Deductions being incurred when the Project is already in default as against potential operational issues (that is, it will depend on the Lenders' perceptions of the possibility of default and the acceptability to the Institution of a period during which it has no right to terminate).

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Agent of a written notice to the Institution to this effect and any rights of the Appointed Representative against the Institution will be cancelled.

(b) The Private Party shall continue to be bound by the terms of the PPP Agreement, notwithstanding the occurrence of the Step-out Date. The Institution shall be entitled to terminate the PPP Agreement after the Step-out Date in accordance with the PPP Agreement.

8 ASSIGNMENT OF PPP AGREEMENT TO SUBSTITUTE PRIVATE PARTY

(a) Subject to Clause 8(b), at any time:

(i) during which an Enforcement Event is subsisting; or

(ii) during the Step-in Period,

the Agent may notify the Institution and the Appointed Representative (if any) of its desire to assign the PPP Agreement to any person and, if so, shall provide the Institution with all information regarding that person that the Institution may reasonably require to determine whether that person meets the criteria described in the definition of "Substitute Private Party".

(b) The Institution shall notify the Agent as to whether such person is approved by the Institution as a Substitute Private Party by no later than [x] days after the Institution has received all the information in Clause 8(a). The Institution shall be entitled to withhold its approval if there is any continuing Private Party Default and the Institution has not received a remedial programme as contemplated in Clause 5(c).

(c) The Agent shall be entitled to assign the PPP Agreement to any such Substitute Private Party; provided that:

(i) (aa) such Substitute Private Party is legally and validly constituted with the legal power and authority to become a party to, and perform the Private Party's rights and obligations under, the PPP Agreement, (bb) the directors of the Substitute Private Party have no criminal convictions, and (cc) the Substitute Private Party has no outstanding tax liabilities (save for any such liability which is the subject of a bona fide dispute);[463]

(ii) if the PPP Agreement is to be assigned prior to the Service Commencement Date, the Service Commencement Date is

[463] These pre-qualification criteria are separate from the criteria to be considered by the Institution in determining the suitability of the person nominated by the Lenders. The Lenders will have to undertake the necessary due diligence to establish whether their nominee satisfies these criteria.

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extended by a period to allow the Substitute Private Party to achieve Service Commencement and to entitle the Substitute Private Party to a Service Period that is equivalent to the original Service Period;

(iii) any accrued Penalty Deductions shall not apply as against such Substitute Private Party; and

(iv) any approvals (if any) that may be required from any Responsible Authority (other than the Institution) under applicable Law for the selection and appointment of such Substitute Private Party shall have been obtained.

(d) On any assignment to any Substitute Private Party becoming effective:

(i) the Private Party shall be released from any obligations arising under or in connection with the PPP Agreement from that assignment date and the Substitute Private Party shall become liable for obligations arising on or after that date;

(ii) any accrued Penalty Deductions shall not apply as against the Substitute Private Party;

(iii) any then subsisting ground for termination of the PPP Agreement by the Institution shall be deemed to have no effect and any subsisting Termination Notice shall be automatically revoked; and

(iv) the Institution shall at the request of the Agent enter into a direct agreement with the Agent and the Substitute Private Party on substantially the same terms as this Direct Agreement.

9 ASSIGNMENT OF THIS DIRECT AGREEMENT

No party to this Direct Agreement may assign any part of its rights or obligations under this Direct Agreement, save that:

(a) the Agent may assign its rights and obligations under this Direct Agreement to a successor Agent in accordance with the Financing Agreements without the consent of the Institution;

(b) any Lender may assign its rights under this Direct Agreement to any Qualifying Financial Institution (as defined in the PPP Agreement)[464] to whom it assigns its rights as Lender under and in accordance with the terms of the Financing Agreements; and

[464] See Part Q:74 (*Refinancing: Exemptions*) which deals with the syndication or sell-down of the Lenders' financing commitments or Debt to Qualifying Financial Institutions.

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(c) the Institution may assign its rights and obligations under this Direct Agreement to any person to whom it assigns its rights and obligations under and in accordance with the terms of the PPP Agreement.

10 MISCELLANEOUS

(a) The Institution shall, at the Private Party's expense, take whatever action the Agent may require to give effect to any assignment in Clause 8 (Assignment of PPP Agreement to a Substitute Private Party).

(b) The Institution shall not take any action to wind-up or liquidate, appoint a liquidator or judicial manager or administrator, or sanction a compromise arrangement (or similar) in relation to the Private Party.

(c) This Direct Agreement shall remain in effect until the date on which all amounts due by the Private Party to the Lenders under the Credit Agreement [465] *have irrevocably been paid in full, whereupon the Agent shall procure the release of any and all security granted in favour of the Lenders (or any security company, trust or other entity established to hold such security) over the Project Assets so that the Project Assets shall be unencumbered. If the amounts so paid to the Lenders exceed the Debt, the Agent shall procure that any such excess is paid to the Private Party or, alternatively, accounted for in the compensation payable by the Institution to the Private Party upon termination.* [466]

(d) The Agent shall notify the Institution of:

(i) any decisions to accelerate the maturity or demand repayment of any Debt; and

(ii) the date referred to in Clause 10(c) on or before the date falling [x] days after its occurrence;

(e) The Private Party joins in this Direct Agreement to acknowledge and consent to the arrangements in this Direct Agreement and agrees not knowingly to do or omit to do anything that may prevent any party from enforcing its rights under this Direct Agreement. [467]

(f) For the avoidance of doubt, if there is any conflict or inconsistency between the provisions of this Direct Agreement and the PPP Agreement, the provisions of the PPP Agreement prevail.

[465] Note the different treatment in Unitary Payment PPP Standardisation.

[466] This must cross-refer to the termination clauses of the PPP Agreement. See **Error! Reference source not found.** (*Termination*).

[467] It is also good practice for the Private Party to appoint the Institution as its attorney to sign any required assignment documentation so that, if assignment occurs, it does so as smoothly as possible.

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(g) The Agent agrees on behalf of itself and the Lenders that [include relevant "boiler plate Clauses" from the PPP Agreement.[468]]

11 GOVERNING LAW AND JURISDICTION

This Direct Agreement is governed by the laws of Pakistan, and is subject to the exclusive jurisdiction of the Civil Court of [x] .

[468] These provisions should be consistent with the provisions of the PPP Agreement and impose an equivalent but separate liability on the Lenders to that to which the Private Party is subject.

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PART P: INFORMATION AND AUDIT ACCESS

70 INFORMATION AND AUDIT ACCESS

70.1 The accounting officer or accounting authority of an Institution is responsible for reporting on the management of a PPP Agreement.

70.2 The Private Party should be under an ongoing obligation to disclose to the Institution all information in connection with the PPP Agreement which the Institution may reasonably require in order to give effect to its financial reporting obligations under various laws including (i) the Regulatory Instruments, (ii) for audit of its accounts under its parent statute or pursuant to the Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001, (iii) for preparation of its accounts pursuant to its parent statue or pursuant to the provisions of the Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001, (iv) for reporting to the Debt Policy Coordination Office established under the Fiscal Responsibility and Debt Management Act, 2005, (v) Freedom of Information Ordinance, 2002, and (vi) other legislation governing health and safety and the environment.

70.3 It should be noted that pursuant to the Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001, the Auditor-General has a discretion:

70.3.1 to determine the nature and extent of any audit carried out by it;

70.3.2 to investigate whether any property or any other assets of an Institution, including any Institution Assets, are being applied efficiently and effectively;

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70.3.3 to investigate any matter relating to expenditure on the part of the Institution being audited by the Auditor-General, including any expenditure in relation to Unitary Payments in Hybrid PPPs; and

70.3.4 to publish details of the utilisation of the assets or resources of an Institution and its expenditure.

70.4 The Institution should ensure that the PPP Agreement contains adequate provisions allowing the Institution to gain access to such information concerning the Project as is reasonably necessary to meet its audit and disclosure obligations.

Standard Clause

Information and Audit Access[469]

(a) The Private Party shall provide to the Institution all information, documents, records and the like in the possession of, or available to, the Private Party as may reasonably be requested by the Institution for the purpose of complying with any of its statutory reporting obligations including its reporting obligations under the [if relevant, name of parent statute of the Institution], [PPP Law], Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001, Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001, and the Fiscal Responsibility and Debt Management Act, 2005.[470]

(b) To this end the Private Party shall use all reasonable endeavours to ensure that all such information in the possession of any counter-party to any Project Document shall be available to the Institution and the Private Party has included, or shall include, appropriate provisions to this effect in all Project Documents.

(c) Without limiting the generality of the aforegoing, the Private Party shall:

(i) provide and shall procure that its Subcontractors shall provide all such information as the Institution may reasonably require from

[469] In this Standard Clause, the scope of the reporting obligation of the Private Party extends not only to financial information but also to any other information that an Institution would be obliged to disclose.

[470] The Private Party and its funders may request a carve-out from this reporting obligation in respect of any financial information relating to the PPP Agreement that extends to the financial arrangements in the Financing Agreements and Shareholders Agreement. This should be considered in light of the aforementioned statutory obligations.

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time to time to enable the Institution to provide reports and returns as required by any Responsible Authority, including reports and returns regarding the physical condition of any building occupied by the Institution, health and safety, national security, and environmental safety; and

(ii) note and facilitate the Institution's compliance with the Freedom of Information Ordinance, 2002 in the event that the Institution is required to provide information to any person pursuant to that Ordinance.

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PART Q: REFINANCING

71 INTRODUCTION

71.1 For the purpose of this Standardisation "**Refinancing**" includes any change in the nature of or the terms governing the funding structure of a Project (that is, in respect of Debt, Equity and/or Shareholder Loans) as it was approved by the Institution at the Signature Date.[471]

71.2 Refinancings which effect, among other things:[472]

71.2.1 a reduction in interest margins applicable to the Debt;

71.2.2 a reduction or release of the cash balances in any reserve accounts or the cancellation or termination (partially or in full) of letters of credit;

71.2.3 a release of contingent liabilities owed by the Shareholders or their Affiliates in respect of their financial obligations to the Private Party and/or the Lenders (or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders);

71.2.4 an extension in the maturity of the Debt;

71.2.5 a rescheduling of the repayment of principal or the payment of interest included in the Debt; or

71.2.6 an increase in the amount of Debt,

may each have the effect of increasing or accelerating the dividends or other distributions deriving from the Project for the benefit of the Shareholders, or of reducing their funding commitments in respect of the Project. This upside

[471] It should be noted that a Refinancing may also be undertaken without the direct involvement of the Private Party, for example, through a special-purpose holding company which relies on rights granted in respect of the cash flows of the Project and other Project Assets of the Private Party (including its rights under its contracts).

[472] This is not a closed list.

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(collectively, referred to as a "**Refinancing Gain**") should be shared between the Institution and the Private Party.

Standard Definitions

*"**Base Case Equity IRR**" means, having regard to the base case Financial Model,* [473] *the nominal post-tax Equity IRR as at the Signature Date, being [x]%;*

*"**Distributions**" means,*

(a) whether in cash or in kind, any:

(i) dividend or distribution of share capital;

(ii) reduction of share capital, stated capital, any capital redemption fund or any share premium account;

(iii) cancellation, conversion, redemption or re-purchase of shares or any other variation whatsoever in share capital;

(iv) payment in respect of the Shareholder Loans (whether of principal, interest, breakage costs or otherwise); or

(v) payment, loan or other financial assistance, transfer of rights or other assets or receipt of any other benefit to the extent put in place after the Signature Date and not in the ordinary course of business, not on an arm's length basis or not otherwise on reasonable commercial terms; or

(b) release of any contingent liability of any of the Shareholders or their Affiliates in respect of their financial obligations to the Private Party and/or the Lenders (or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders). Such release shall be deemed to be a cash amount for the purpose of calculating the Refinancing Gain;

*"**Equity IRR**" means the projected blended*[474] *rate of return to the Shareholders and their Affiliates over the full Project Term, having regard to Distributions made and forecast to be made;*

*"**Net Present Value**" or "**NPV**" means the aggregate of the discounted values, calculated as at the estimated date of the Refinancing, of each of the relevant projected Distributions, in each case discounted using the Base Case Equity IRR;*

[473] This is the base case equity IRR in the Financial Model as at the Signature Date.

[474] That is, including both the Equity and the Shareholder Loans.

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*"**Permitted Borrowing**" means, at any time after the Signature Date, any advance made to the Private Party under the Financing Agreements for the purpose(s) specified therein;*[475]

*"**Refinancing**" means, at any time after the Signature Date:*

(a) any amendment, assignment, novation, replacement or supplementing of any of the Financing Agreements (or the Agreed Form thereof, if any such agreement has not been executed by the Signature Date), whether independently or in combination with any connected arrangements;

(b) the exercise of any right or grant of any waiver, indulgence or approval under any of the Financing Agreements (other than a Permitted Borrowing);

(c) the disposition or encumbering (by whatever means) of any rights under any of the Financing Agreements or the creation or granting of any other benefit or interest in any of the Financing Agreements or any of the Private Party's other contracts, Project revenues or Project Assets; or[476]

(d) any other arrangements having any of the effects in Clauses (a) to (c) (inclusive);

*"**Refinancing Gain**" means in relation to any Refinancing (other than an Exempt Refinancing), an amount equal to the greater of nil and [(A - B) - C], where:*

A = the Net Present Value of the Distributions forecast immediately prior to such Refinancing (having regard to the Financial Model, as updated to that time), taking into account the effect of the Refinancing, including the costs of the Refinancing, to be made over the remaining Project Term;

B = the Net Present Value of the Distributions forecast immediately prior to such Refinancing (having regard to the Financial Model, as updated to that time), not taking into account the effect of the Refinancing or the costs of the Refinancing, to be made over the remaining Project Term; and

[475] If the facilities committed by the Lenders at the Signature Date (or, where the Financing Agreements are executed after the Signature Date, on the terms included in the Agreed Form thereof) include a standby facility for the purpose of funding any unforeseen cost overruns, increased expenses or losses of revenue incurred by the Private Party, then the reference to "advance" in this definition must specify this purpose in relation to such standby facility so that the facility will not be applied to prepay amounts owed to the Shareholders under the Shareholder Loans, thereby providing an escape route for avoiding Refinancing Gains.

[476] This is intended to capture any payments or the like to Affiliates of the Private Party and each of its Shareholders that are "dressed up" as ordinary payments for operational or capital expenditure (but are really profits) in order to avoid the sharing of Refinancing Gains.

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C = any adjustment required to raise the nominal post-tax Equity IRR calculated immediately prior to such Refinancing (having regard to the Financial Model, as updated to reflect all changes in the operating assumptions for the Project, and taking into account the actual performance of the Project to that time)[477] *to the Base Case Equity IRR.*

72 KEY PRINCIPLES

72.1 The key principles underlying the prescribed approach to Refinancing are as follows:

72.1.1 Refinancings may be of benefit to both the Private Party and the Institution;

72.1.2 a Refinancing may constitute a material change to the funding structure of a PPP as agreed between the Parties at the Signature Date. Therefore, an Institution should generally have the right under the PPP Agreement to be fully informed of any proposed Refinancing and must notify the Approval Authority in advance thereof save in the case of a Refinancing as described in (d) of the definition of Exempt Refinancing,[478] for which no advance notification is required. Further the Institution must have the right to pre-approve any proposed Refinancing, other than Exempt Refinancings. The exercise of this pre-approval right by the Institution is subject to any approvals required pursuant to the Regulatory Instruments in relation to amendments to the PPP Agreement;

72.1.3 although increases in the returns to investors in the Private Party due to improved performance (over and above those anticipated at Financial Close) should generally be for their benefit, where increased returns derive from changes in the nature of or the terms governing the funding

[477] See Section 0 (*Calculation*).

[478] See Section 74 (*Exemptions*).

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structure of the Project they should be shared between the Institution and investors;

72.1.4 as the PPP market in Pakistan matures and stabilises, better funding terms should become available. In the broadest sense, both the public sector and the private sector will contribute in bringing about this improvement. Therefore, both sectors should share in the improved terms available for Refinancings; and

72.1.5 a 50:50 sharing of the Refinancing Gains between the end users and the Private Party provides a fair balance.

72.2 The complexity of Refinancings means that it is important that Institutions seek appropriate financial and legal advice when considering the subject to ensure that the prescribed approach in this Standardisation is properly reflected in the PPP Agreement, the Project Documents and any negotiations with the private sector on proposed Refinancings.

73 INSTITUTION APPROVAL

73.1 For Certain Refinancings

73.1.1 An Institution should generally have the right to pre-approve any proposed Refinancing, save for "Exempt Refinancings" (as defined in Section 74 (*Exemptions*)).

73.1.2 When evaluating a proposed Refinancing, an Institution should carefully consider whether the effects of such proposal might:

73.1.2.1 increase the risks borne by the Institution;

73.1.2.2 impact on the Private Party's ability or capacity to manage and mitigate the risks allocated to the Private Party under the PPP Agreement;

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73.1.2.3 reduce incentives for the Private Party to achieve sustained service standards over the remainder of the Project Term; or

73.1.2.4 undermine the financial stability of the Private Party, thereby endangering the provision of the Project Deliverables.

73.1.3 When considering a request for approval of a proposed Refinancing, the Institution should objectively assess the Private Party's proposals. There may be occasions where, for good reasons, the Institution refuses to approve a Refinancing despite the opportunity to share any resultant Refinancing Gains. A refusal to approve a Refinancing may be appropriate, for example, where the Private Party proposes a new funding structure, which the Institution perceives to be far less flexible than the structure it replaces in projects where the Institution places a high value on flexibility. However, an Institution should not use its right to pre-approve any increases in its termination liabilities to agree to a greater than 50% share of any Refinancing Gain.

73.1.4 Generally, Refinancings that increase the risks borne by the Institution (for instance, by replacing Equity and/or Shareholder Loans with new Debt) will also result in greater gains for sharing. Any material change in the risk profile of a Project must be pre-approved by the relevant Treasury pursuant to the Regulatory Instruments, which is unlikely to withhold its approval if the Institution's 50% share of the Refinancing Gains is reasonable compensation for the increased risks it is being asked to bear as a result of the new funding structure; provided that the required value for money and affordability are sustained.

73.2 For Increases in Termination Liabilities

The PPP Agreement should provide that if a proposed Refinancing involves an increase in the liability of an Institution upon termination of the

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PPP Agreement (for instance, increases in the Debt, the Shareholder Loans or the Equity beyond that agreed at the Signature Date), then the Institution's approval would be required for such increase in the Institution's termination liabilities as a *separate and distinct* approval from the approval (if any) required for the Refinancing. The Institution's capacity to agree to a change in its termination liabilities is also subject to the requirement for the approval of the relevant Treasury. That approval will hinge on, among other things, any affordability constraints.

74 EXEMPTIONS

The following Refinancings should be subject to prior notification to the Institution but not be subject to either prior approval by the Institution (save as provided in Section 73.2 (*For Increases in Termination Liabilities*)) or any sharing of the Refinancing Gains:

74.1 Shareholder Capital

74.1.1 Any disposals of investments or commitments of capital in the Private Party that are Equity or Shareholder Loans should be exempt from the Refinancing approval and sharing restrictions. This exemption is subject to any prior approvals required in relation to any Changes in Control (see Part S:78.3 (*Miscellaneous: Changes in Shareholding and Control*)).

74.1.2 Similarly exempt are payments of dividends in respect of the Equity and payments in respect of the Shareholder Loans (but only after all other creditors having rights in relation to the cash flows of the Project and other assets of the Private Party have been paid).[479]

[479] This assumes that the project finance structure (as set out in the Financing Agreements) will provide for the ordinary cash flow "waterfall" structure, which places payments to the Shareholders (and other Distributions) last in the line of payees (after payment of capital expenditure and operating costs, taxes, debt service and reserves).

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74.2 Base Case Refinancings

74.2.1 The bidders should be encouraged in the RFP to anticipate the gains from Refinancings in their bids. Refinancings that are clearly and fully included in the base case Financial Model at the Signature Date and taken into account in the calculation of the User Charges should therefore be exempt from Institution approval and gain-sharing up to the amount included in that base case.

74.2.2 To guard against the Private Party seeking to use this exemption to bypass the Refinancing Gain sharing provisions, the due diligence to be undertaken by the Institution and its advisors should extend to any Refinancing assumptions that have been taken into account in any bids. If an Institution receives a bid, which claims to take into account future Refinancings, then the Institution should specifically identify this in its application for the relevant Approving Authority Approval.

74.3 Corporate Finance

74.3.1 Projects originally undertaken on a strictly corporate finance basis[480] should be exempt from any Refinancing approvals or gain-sharing. In the due diligence to be undertaken by the Institution (and its advisors) an assessment must be made of the structure and nature of a bid being put forward on a corporate finance basis to confirm that the funding structure being proposed is a true corporate finance structure and not one designed to bypass the Refinancing provisions.[481]

74.3.2 Whether or not a bid proposes a corporate finance structure should be determined on a project-by-project basis.

[480] As regards the basic differences between a corporate finance and project finance structure see (C) (*Other Funding Structures*) in the Preface.

[481] When applying for the corresponding Approvals of the Approving Authority in respect of the evaluation of the bids received in a PPP procurement, the Institution must clearly identify the nature of the funding structure (that is, corporate finance or project finance or other) of the preferred bidder in order to establish whether the Refinancing provisions will apply to this bidder.

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74.3.3 This exemption applies only to the extent that such corporate finance arrangements are implemented at the Signature Date, since the benefits to an Institution of a corporate finance approach cannot be retrospectively introduced and are fundamental to the justification of this exemption. If the Private Party subsequently seeks to introduce a project finance structure to a Project that has initially been corporate financed, the PPP Agreement (and the Financial Model) will have to be renegotiated to reflect the new funding structure and a reallocation of benefits will then become necessary so as to include provisions on Refinancing. Any new funding structure will obviously be a material change for the purposes of the Regulatory Instruments and, accordingly, the Institution will have no capacity to agree to such a change without the prior approval of the relevant Treasury.

74.4 Taxation and Accounting Policies

Changes in taxation or in the Private Party's accounting policies, such as depreciation, are not considered to be Refinancings.[482]

74.5 Syndications

Refinancings do not include the sell-down of financing commitments or the assignment of participations in the Debt by the original Lenders to a Qualifying Financial Institution (see the Standard Definition below).

[482] However, with regard to Part B:4 (*Project Documents and Project Deliverables: Project Documents*), if these changes involve any amendments to Project Documents, then the Institution's (and the Approval Authority's) approval will be required and should be subject to the usual critical due diligence as to their likely impact on risk transfer, affordability and value for money. Institutions must inform the Approval Authority regarding any such proposed change for which its approval is required.

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Standard Definitions[483]

*"**Exempt Refinancing**" means any Refinancing:*

(a) that effects a sale or cession of the whole or any part of Equity or the Shareholder Loans or securitisation of the rights attaching to the Equity or the Shareholder Loans; provided that this exemption shall not limit the application of Clause [x] (Change in Control);[484]

(b) that was taken account of fully in the calculation of the User Charges;

(c) that arises solely from a change in taxation or accounting treatment;

(d) that comprises a waiver, approval or any similar action taken in respect of breaches of warranties or representations or the late or non-provision of required information, and which occurs in the ordinary day-to-day administration of the Financing Agreements, the Shareholders Agreements or the Subcontracts; or

(e) that effects any syndication, sell-down, cession or grant of any rights of participation or security by the Lenders (or any agent acting on their behalf, or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders) of or in relation to any of its rights under any of the Financing Agreements in favour of any Qualifying Financial Institution.

*"**Qualifying Financial Institution**" means a bank as defined in the Banking Companies Ordinance, 1962, a Non-Banking Finance Company as defined under Part VIII-A of the Companies Ordinance, 1984, or a financial institution as defined in the Financial Institutions (Recovery of Finances) Ordinance, 2001.*

75 METHOD OF CALCULATING, SHARING AND PAYING REFINANCING GAINS

75.1 The PPP Agreement will not set out the detailed basis and method of calculating the Refinancing Gains as these will vary depending on the type of Refinancing and will need to be agreed between the Parties at the time of the Refinancing.

[483] This definition follows the assumption that the Project will be funded substantially on a project finance basis. If the Project is funded on a strictly corporate finance basis or on a corporate finance basis with capital contributions from the Institution, then these Refinancing Clauses and definitions should not be incorporated in the PPP Agreement.

[484] See Part S:78.3 (*Miscellaneous: Changes in Shareholding and Control*).

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75.2 High-level principles for calculating, sharing and paying Refinancing Gains are set out below. If an Institution wishes to deviate from these principles, it must indicate its intention in this regard to the relevant Treasury when applying for relevant Approving Authority Approval. If these deviations are proposed by any bidders, then these deviations must be clearly indicated in their bid documents. The Approval Authority will consider an alternative approach if it demonstrates better value for money (for example, where there is a substantial residual value or demand risk or where there is substantial Ancillary Income).

Calculation

(a) The Refinancing Gain is derived from changes in the Distributions forecast to take place after the Refinancing when compared with the position immediately before the Refinancing.

(b) These changes can be negative and positive. For example, if the Private Party raises additional amounts of debt, that additional debt will probably be paid out as an immediate Distribution (for example, to prepay the subordinated Shareholder Loans), and will thus be an increase compared to the pre-Refinancing position. Thereafter, however, as the amount of the overall debt has increased, debt service payments will be greater and future Distributions lower than the pre-Refinancing position.

(c) These positive and negative changes in the Distributions should be discounted to their NPV at the date of the Refinancing. The result of this NPV calculation is the Refinancing Gain. Thus the Refinancing Gain is not necessarily an actual cash sum as at the date of the Refinancing and the payment method for the Institution's share must take this into account.

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(d) The prescribed discount rate for the NPV calculation is the Base Case Equity IRR. This is because if the funders did not undertake the Refinancing, then this is the original rate of return they would be earning from the capital invested by them in the Project, so the gains to be derived from the Refinancing should be benchmarked against this rate. The funders might argue that the discount rate should be the equity IRR that an investor in the Project at the time of the Refinancing would expect to earn, because this reflects the actual risk profile and performance of the Project at the time of the Refinancing. However, there is no objective way of determining this rate in advance and leaving it to be determined at the time of the Refinancing will create opportunities for a rate to be constructed that might not be fair to all parties.

(e) To the extent that the payment of the Institution's share of the Refinancing Gain is tax-deductible, this benefit to the Private Party should be taken into account in the calculation.

Sharing

(a) The Institution may only take its 50% of the NPV of the gains to be derived from a Refinancing after an adjustment is made that allows for the exclusion of that portion of the gain which was originally projected to be made (that is, excluding that part of the gain which achieves the Base Case Equity IRR) and before taking the Refinancing Gain into account.

(b) Accordingly, if the Equity IRR before the Refinancing is less than the Base Case Equity IRR, then that portion of the gain deriving from the Refinancing which, if received by the Shareholders as at the Refinancing date, would increase the Equity IRR before the Refinancing up to the Base Case IRR, should be excluded from the

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gain-sharing and the Institution should only share in the balance of the gains deriving from the Refinancing.

(c) Consequently, the Base Case Equity IRR is of key significance to the Institution, which during the course of its due diligence must satisfy itself as to the reasonableness of this rate. This is a critical issue if competition has been weak such that either the Base Case Equity IRR is artificially high or, conversely, the Base Case Equity IRR is artificially low given the use of overly conservative assumptions (for example, in relation to accounting policies, changes to which are exempt from the sharing of any Refinancing Gains).

(d) Although this approach is an equitable one, it will create scope for the manipulation and exaggeration of projections to show that the Base Case Equity IRR has not been passed. The Institution should, therefore, ensure that it is in a position to understand the pre-Refinancing Equity IRR and Base Case Equity IRR and to properly evaluate the past and projected performance of the Project applying the pre-Refinancing Equity IRR and Base Case Equity IRR. To do so, it will need the following information from the Private Party:

(i) the base case Financial Model with the projections that were originally used to calculate the User Charges, adjusted for any changes in the Project structure and funding (for example, Institution Variations) which have taken place since the Signature Date;

(ii) details of the actual timing and amounts of the cash investments of the Equity and the Shareholder Loans from

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the Signature Date to date (and estimated to the Refinancing date);

(iii) information on the actual cash flow of the Private Party from the Signature Date to date (and estimated to the Refinancing date), all set out under the same headings as in the base case Financial Model;

(iv) details of the actual timing and amounts of all Distributions from the Signature Date to date (and estimated to the Refinancing date);

(v) a pre-Refinancing financial model with projections for the cash flow of the Private Party from the estimated Refinancing date to the end of the Project Term, including projected Distributions,[485] before taking the Refinancing into account;

(vi) term sheet or other relevant information on the terms of the Refinancing;

(vii) a post-Refinancing financial model with projections for the cash flow of the Private Party from the estimated Refinancing date to the end of the Project Term, including projected Distributions, after taking the Refinancing into account;

(viii) a calculation of the Refinancing Gain based on the above; and

[485] Unless there is some clear reason to the contrary, the assumption should be made that all surplus cash flow is paid out not less than six-monthly as Distributions, to avoid underestimation of the Equity IRR.

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(ix) information on the assumptions for the projections in the pre-and post-Refinancing financial models.

Payment

(a) The Institution's 50% share of the Refinancing Gain must translate into a corresponding reduction of the User Charges (and the Unitary Payment as well in Hybrid IPPs). Unlike Unitary Payment PPPs, the Institution should not have the option to take its 50% share as a lump sum payment.

(e) The Institution's share of Refinancing Gains to be paid by way of reduced User Charges (and Unitary Payment in Hybrid PPPs) should not be conditional on the future performance of the Project.

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76 AUDIT RIGHTS, TRANSACTION COSTS AND TERMINATION

76.1 Audit Rights and Transaction Costs

76.1.1 In order to enable the Institution to determine whether or not any Refinancing is subject to its prior approval and its entitlement to any Refinancing Gains, the Institution must have the right (exercisable at any time before the Refinancing is implemented) to audit the financial model used for the Refinancing and the calculation of the Refinancing Gains, and the underlying assumptions for the data and projections used in the

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model, and to review documentation resulting from the Refinancing, even if the Refinancing appears to be an Exempt Refinancing.[486]

76.1.2 This audit right is also important to enable the Institution to assess the potential adverse impact (if any) of the proposed Refinancing on the Institution's termination liabilities and on the Private Party's incentive to sustain the required service standards over the remainder of the Project Term.

76.1.3 The Private Party must reimburse the Institution for its reasonable costs of engaging suitable advisors to review and advise it regarding any Refinancing or Exempt Refinancing proposals. The Refinancing Gain must be calculated after deducting any reasonable third party costs incurred by the Parties in connection with the proposed Refinancing.

Standard Clause

Refinancing

(a) The Private Party shall promptly notify the Institution in writing prior to taking any steps to implement any proposed Refinancing (including any Exempt Refinancing, save for an Exempt Refinancing as described in (d) of the definition thereof). Such notice shall include (i) full details of any proposed amendments to be made to or waivers granted under any of the Project Documents to give effect to such Refinancing, (ii) a copy of the proposed financial model relating to such Refinancing (if any) and the basis for the assumptions used in that financial model, (iii) the reasons for such Refinancing and (iv) any other information that may be reasonably necessary to enable the Institution to assess such Refinancing having regard to the following provisions.

(b) The Private Party shall procure that no Refinancing (other than an Exempt Refinancing) is implemented without the prior written approval of the Institution. For the avoidance of doubt, the Institution's liabilities in relation to Compensation payable upon termination shall not increase as a result of Refinancing where prior permission of the Institution is not obtained; provided, in such case,

[486] See also Section 0(d) above.

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the Institution's liability in relation to Compensation shall be the lower of the amount payable before and after Refinancing.

(c) Subject to Clause (a), the Private Party may implement any Exempt Refinancing without the prior approval of the Institution.

(d) The Institution shall be entitled to receive a 50% share of the Refinancing Gain arising from any Refinancing (other than an Exempt Refinancing) by way of a corresponding reduction to the User Charges [and, the Unitary Payments] over the remaining Project Term, and the Financial Model shall be revised accordingly.

(e) The Institution shall be entitled on prior written notice to the Private Party (at any time before, during and/or after any Refinancing) to audit any financial model and documentation relating to any Refinancing (including any aspect of the calculation of the Refinancing Gain).

(f) The Institution and the Private Party will negotiate in good faith to agree the basis and method of calculation of the Refinancing Gain and payment of the Institution's share of the Refinancing Gain under Clause (d).. If the Parties fail to agree the basis and method of calculation of the Refinancing Gain or the payment of the Institution's share, then the dispute shall be determined in accordance with Clause [x] (Fast-track Dispute Resolution).[487]

(g) The Refinancing Gain shall be calculated after taking into account (i) the reasonable and proper professional costs that each Party incurs directly in relation to such Refinancing, and (ii) if the Institution's share of the Refinancing Gain is deductible in the hands of the Private Party for income tax purposes, the resulting tax benefits to the Private Party. The Private Party shall pay to the Institution all such costs incurred by the Institution within [x] days of any such Refinancing.

(h) For the avoidance of any doubt, the notification and approval requirements set forth in this Clause (x) (Refinancing) do not apply to any Permitted Borrowing.

[487] Any dispute should be determined in accordance with the fast-track dispute resolution procedure provided for in the PPP Agreement. See the Standard Clause in Part S:81.2 (*Miscellaneous: Fast-track Dispute Resolution*).

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76.2 Termination

The Institution may terminate the PPP Agreement for any breach of the Refinancing provisions. In such circumstances, the amount of compensation payable to the Private Party shall be the same as that paid to the Private Party if the PPP Agreement is terminated for Private Party Default.

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PART R: INTELLECTUAL PROPERTY

77 INTELLECTUAL PROPERTY

77.1 Introduction[488]

77.1.1 In most PPPs, the Private Party will need to use some type of intellectual property in order to perform the Project Deliverables. The Private Party may use intellectual property that it has developed. However, given that the Private Party is an SPV and that the Project Deliverables will be subcontracted, it is more likely to use intellectual property developed by third parties (including the Subcontractors, their Affiliates or other parties). If the Private Party uses third party intellectual property, the Private Party will need a licence to lawfully use that intellectual property. Intellectual property licences typically contain provisions that prohibit the licencee from transferring its rights under the licences to third parties or allowing third parties to use the intellectual property.

77.1.2 Accordingly, Institutions must review all Licensed Intellectual Property made available by the Private Party to ensure that the terms of the licences permit the Institution (or its nominee)[489] to use the intellectual property:

77.1.2.1 during any Institution step-in period;[490]

[488] In PPPs involving substantial IT components, the rights attaching to intellectual property and the scope of protections required to deal with infringements of intellectual property rights will have to be more refined than is dealt with in this Part R: (Intellectual Property). Given, among other things, the complexities associated with this kind of technology. Accordingly, an Institution involved in an IT project must obtain appropriate technical and legal advice in the phase preceding its application for the relevant Approving Authority's Approval.

[489] This nominee includes any New Private Party appointed by the Institution pursuant to the Retendering procedure (if applicable) following a Private Party Default. See Part N:50 (*Termination: Compensation on Termination for Private Party Default, Retendering Procedure*).

[490] The Lenders will also be concerned that their Appointed Representative will be able to lawfully use the Licensed Intellectual Property during any Lenders' step-in under the Direct Agreement and that, should the Lenders exercise their substitution rights under the Direct Agreement, the intellectual property licences will be freely transferable to the Substitute Private Party appointed pursuant thereto.

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77.1.2.2 following the termination of the PPP Agreement for any reason (whether this is an Institution Default, a Private Party Default, a Force Majeure event or a Corrupt Act); and

77.1.2.3 following the expiry of the PPP Agreement, unless the Licensed Intellectual Property is not critical for the continued performance of the institutional function previously performed by the Private Party through the Services and alternative intellectual property is available at a cost that will not materially reduce the value for money of the intellectual property requirements of the Institution.

The Institution's requirements here must be specified in the RFP so that all the bidders are given the opportunity to obtain the necessary consent rights and adequately price for the cost of these rights in their bids.

77.1.3 Irrespective of who owns the Licensed Intellectual Property to be procured by the Private Party for the Project, the PPP Agreement must provide for the use rights contemplated in Section 77.1.2.[491] The use rights required during any Institution step-in period or following the termination of the PPP Agreement must not attract any royalties for the Institution. This is based on the assumption that the cost of these use rights will be included in the User Charges and/or the termination compensation. Whether the use rights required after the *expiry* of the Project Term should attract any royalties will depend on:

77.1.3.1 whether the use rights are required only for the continued performance of the same institutional function performed by the Private Party through the Services or whether they are required for the performance of any other institutional functions; and

[491] See also Part N: 56(*Termination: Effects of Termination*), particularly Standard Clause (e).

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77.1.3.2 whether the Intellectual Property is specifically developed or custom-made for the institutional function performed through the Services ("**Customised Intellectual Property**").[492]

77.1.4 Where any Institution Assets to be made available to the Private Party include Intellectual Property owned by the Institution (for example, its name, logo, and so forth) or used by the Institution under licence, the Institution should seek legal advice regarding how the Private Party's use rights should be structured, particularly if the Institution wishes to preserve any rights in respect of this Intellectual Property.[493] In the case of intellectual property licensed to the Institution, the Institution must have regard to any licence restrictions impacting on the Institution's ability to permit the Private Party to use that intellectual property.

77.1.5 The PPP Agreement must require each Party not to infringe the rights of third parties in respect of any Licensed Intellectual Property, including any rights of the licensor arising under any licence relating to such Licensed Intellectual Property. The PPP Agreement must set out the consequences of any such infringement.

77.2 Infringement

77.2.1 Where the Private Party infringes the rights of third parties in respect of the Licensed Intellectual Property, the following should apply:

77.2.1.1 the general principle is that any losses resulting from infringement by the Private Party of such rights should be borne by the Private Party. It should be responsible for any losses of the owner of those rights and any direct losses of the Institution. The Private Party indemnities (see the prescribed approach in Part C:9 (*General*

[492] See Section 77.3 (*Intellectual Property Rights on Termination and Expiry*) below.

[493] See the Standard Clause in Section 77.4 (*Intellectual Property of the Institution*).

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Obligations: Indemnities and Claims for Damages) and Part C:10 (*General Obligations: Double Recovery and Mitigation*) should extend to third party claims against the Institution arising from the infringement of those rights; and

77.2.1.2 if the infringement or related legal action threatens the performance of the Project Deliverables, the Institution should be notified as soon as possible. The Institution should be obliged to provide reasonable assistance to the Private Party in defending any legal action to the extent necessary to preserve the continued performance of Project Deliverables, but this should not extend to meeting any costs of the Private Party's defence.

77.2.2 If the Institution infringes the rights of any third parties in respect of the Licensed Intellectual Property, it should bear the costs of any resulting third party claims, save to the extent that such infringement results from the Private Party's conduct. Since these costs may include the consequential losses of the owner of the intellectual property and any costs incurred by the Private Party (for instance, if it is sued by the owner and it needs to obtain a licence for replacement intellectual property rights from another person) the exposure of the Institution might be great. Accordingly, it is critical that the Institution conducts a thorough due diligence on all Licensed Intellectual Property procured by the Private Party for the Project. The Institution should also ensure that the PPP Agreement incorporates appropriate undertakings from the Private Party regarding the use of the Licensed Intellectual Property by the Institution (or its nominee). These use rights should generally permit the Institution (or its nominee) to use the Licensed Intellectual Property in the continued provision of the Project Deliverables during any Institution step-in and, where the PPP Agreement is terminated or expires (save as provided in Section 77.1.2.3), in the continued delivery of the same

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institutional function previously performed by the Private Party; subject in either case to any reasonable limitations on the abuse of such use rights. Any indemnities granted by the Institution regarding such abuse should be consistent with the approach prescribed in Part C:9 (*General Obligations: Indemnities and Claims for Damages*) and Part C:10 (*General Obligations: Double Recovery and Mitigation*).

77.2.3 Where the Institution may itself contribute any Licensed Intellectual Property to the Project for the Private Party to use in the performance of the Project Deliverables, it must ensure that it has the rights to do so (see Section 77.1.4). In addition, the Institution should make available to all the bidders the terms of the licences held by it in respect of third party intellectual property (unless the terms of the licences prohibit the Institution from doing so)[494] so that the bidders can satisfy themselves as to any consent they may need from the licensors. Assuming that all necessary consents are obtained from the licensor so that the Private Party is permitted to use the Licensed Intellectual Property, the PPP Agreement should include reasonable limitations relating to the abuse of those use rights by the Private Party and also indemnities to protect the Institution against such abuse. These Private Party indemnities should also reflect the prescribed approach.

77.3 Intellectual Property Rights on Termination and Expiry

77.3.1 The PPP Agreement will also need to deal with what happens to Intellectual Property at the end of the Project Term (that is, both on termination and expiry of the PPP Agreement). The following principles generally apply.

[494] Typically these licences will impose confidentiality restrictions and, if they do, the Institution should first obtain the consent of the licensor to the disclosure of these licences.

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77.3.2 All Intellectual Property (if any) belonging to the Private Party must be transferred to the Institution. All use rights of the Private Party (and/or any Subcontractor) in respect of Intellectual Property (if any) made available by the Institution to the Private Party, including any Licensed Intellectual Property, must be relinquished.

77.3.3 In the case of any Licensed Intellectual Property procured by the Private Party, the Institution should be entitled to a perpetual licence to use any such Licensed Intellectual Property if it is Customised Intellectual Property. This licence should allow the Institution (or its nominee) to use such Customised Intellectual Property either:

77.3.3.1 for the continued performance of the same institutional function previously performed by the Private Party through the Project Deliverables, *free of any future royalties* on the assumption that such Intellectual Property would have been paid for in full through the User Charges and/or the termination compensation. Here the Institution (and its nominee) would not be entitled to use the Intellectual Property in the performance of any other institutional function or for any other purpose; or

77.3.3.2 for the continued performance of the same institutional function previously performed by the Private Party through the Project Deliverables *and* for any other purposes (whether in similar projects or in any other projects). Here the Institution should expect that such *extended* use rights might come at a price.

The choice between these alternatives will depend on which provides better value for money.

77.3.4 In respect of Licensed Intellectual Property that is not Customised Intellectual Property but is nevertheless required for the continued

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performance after the termination or expiry of the Project Term of the institutional function previously performed by the Private Party, the Private Party must be under an obligation to ensure that the Institution is entitled to use such Licensed Intellectual Property as aforesaid either itself or through a nominee. Such use rights must also be secured for any Institution step-in period. The Private Party should also ensure that any royalties payable by the Institution for the use rights in the period following the *expiry* of the PPP Agreement should be at reasonable commercial rates. It is for the Private Party to ensure that the licences that it (or any Subcontractor) concludes in respect of such Licensed Intellectual Property reflect these entitlements. The Institution must seek an indemnity from the Private Party in respect of any direct losses it might incur if it is not entitled to use such Licensed Intellectual Property either directly or through a nominee. Thus, if the Private Party chooses to use proprietary third party software in the operation of any Facilities used in the performance of the Project Deliverables, it must bear the risk of the third party not agreeing to the Institution (or its nominee) using such software during any Institution step-in period or after the termination or expiry of the Project Term. Similarly, the Private Party must bear the risk of the third party licensor being prevented from permitting the Institution (or its nominee) to use the Licensed Intellectual Software because of restrictions imposed by that licensor's government. If the Private Party is reluctant to bear those risks, then it should find alternative intellectual property that is capable of being used by the Institution (or its nominee).

77.3.5 In addition, arrangements should wherever possible be put in place to ensure that the Institution has immediate access to any information and materials required to use the Intellectual Property. In this regard, it is prescribed that the source codes of all software products used in the

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operation of the Facilities should be held in trust (sometimes referred to as "in escrow") by an independent party, and the Institution (or its nominee) should be entitled to have access to any source code whenever it becomes entitled to the Intellectual Property to which it relates.[495]

77.3.6 It should also be noted that a New Private Party would need access to all such information and materials as well as the Intellectual Property in advance of the conclusion of the New PPP Agreement in order to acquaint itself with the Project Deliverables and facilitate the smooth hand over to it of the Facilities.[496] These access rights should be negotiated in advance rather than being left to be resolved on termination of the PPP Agreement.

77.4 Intellectual Property of the Institution

The uses of the Institution's own intellectual property by the Private Party also needs to be provided for in the PPP Agreement.

Standard Clause[497]

Intellectual Property of the Institution

(a) All intellectual property rights whatsoever, whether capable of registration or not, regarding the Institution's name, trademarks, logos, image and all other intellectual property matters relating to the Institution, including its name, trademarks, logos and/or image shall remain the sole property of the Institution.

(b) Subject to existing rights and obligations and Clause (c), the Institution shall, on prior written application by the Private Party, grant a non-exclusive revocable right and licence to the Private Party to use the Institution's trademarks and logos for a period not to exceed the remainder of the Project Term.

[495] Source codes are particularly critical for the upgrade of software, which may prove to be more cost-effective than buying new software. Given the extended duration of PPPs, software upgrades will probably be unavoidable.

[496] The Lenders will have the same concerns in relation to the Substitute Private Party.

[497] This Standard Clause only relates to the Intellectual Property of the Institution (in the nature of its name, trademarks, logos, image and the like) made available to the Private Party. If the intellectual property includes information technology or business secrets or the like, this Standard Clause will need to be supplemented.

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(c) In order to establish and maintain standards of quality and propriety acceptable to the Institution, in the event that the Private Party desires to use the Institution's trademarks or logos in any way, the Private Party shall first submit the concept or a sample of the proposed use to the Institution for approval, which shall be in its sole and absolute discretion. The Institution shall use reasonable endeavours to advise the Private Party of its approval or disapproval of the concept or sample within [x] Business Days of its receipt of the concept or sample. If the Institution approves the concept or sample, the Private Party shall not depart therefrom in any respect without the Institution's further prior written approval.

(d) If at any time the Institution revokes its approval for the specified use of any trademark or logo, the Private Party shall forthwith discontinue all use of such trademark or logo and shall remove from public sale or distribution any previously approved product in respect of which the Institution has revoked its approval. The costs incurred by the Private Party as a result of such revocation shall be borne by the Private Party if the grounds for the revocation include any ground described in Clause (e).

(e) The Institution may revoke its approval immediately upon [x] Business Days written notice to the Private Party if the Private Party, any Subcontractor or any of its or its Subcontractors' officers, directors or employees commits any crime or otherwise engages in conduct which violates any law, or engages in any conduct that offends against public morals and decency and, in the Institution's reasonable opinion, materially prejudices the reputation and public goodwill of the Institution.

(f) The Private Party acknowledges that the name(s) of the Institution (the "Protected Names") are associated with and peculiar to the Institution and are the intellectual property of the Institution. Consequently, the Private Party agrees that the sole and exclusive ownership of the Protected Names shall vest in the Institution.

(g) In circumstances where the Private Party utilises any of the Protected Names, either on its own or in combination or association with any other name, it does so only in terms of this PPP Agreement and with the prior approval of the Institution. On termination or expiry of this PPP Agreement, the Private Party shall not be entitled to operate or conduct any business using any of the Protected Names either on its own or in combination or association with any other name.

(h) Within [x]Business Days after the end of the Project Term and where the Private Party has operated a company utilising any of the Protected Names with the permission of the Institution, the Private Party shall either:

(i) de-register the company bearing any of the Protected Names; or

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(ii) change the name to a name not substantially similar to any of the Protected Names.

(i) The naming of the Private Party's business operation shall be undertaken in consultation with the Institution and subject to the Institution's approval. In circumstances where the name chosen by the Private Party and approved by the Institution is not part of the Institution's intellectual property, then the rights of the Institution contemplated in Clause (h) shall not be applicable and the intellectual property shall be the sole property of the Private Party.

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PART S: MISCELLANEOUS

78 ASSIGNMENT, SUBCONTRACTING AND CHANGES IN SHAREHOLDING AND CONTROL

78.1 Assignment

78.1.1 A contracting party:

78.1.1.1 may freely cede its contractual rights to a third party without the consent of the other contracting party, unless their contract prohibits such cession; and

78.1.1.2 may not delegate its contractual obligations to a third party unless the contract permits such delegation.

78.1.2 It is common practice for contracting parties to specifically agree in their contract that neither of them may cede its contractual rights or delegate its contractual obligations (the terms "cede" and "delegate" being collectively referred to as "assign") without the prior consent of the other. This restriction provides each contracting party with a means to prevent the exit of a party it has identified as a suitable partner and the entry in its place of a new contracting party whom it may not know or may even consider to be unsuitable.[498]

78.1.3 In long-term contracts such as a PPP, some parties may, however, not want to have their exit restricted in any way and accordingly may require the flexibility to proceed with an assignment of their rights and obligations without the consent of the other parties. This flexibility should not generally be allowed in a PPP save as permitted below.

[498] This contractual restriction is not inviolable. For instance, corporate parties intent on exiting can do so at parent company level. Accordingly, additional protections will need to be built into a contract to give effect to the exit restrictions.

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78.1.4 The PPP Agreement should not allow the Private Party to assign its rights and obligations, or even merely to cede its rights under the PPP Agreement, except as part of the Lenders' security package as reflected in the Direct Agreement. Given, however, that a Substitute Private Party may be appointed in accordance with the Direct Agreement, the PPP Agreement should allow for the original Private Party's rights and obligations under the PPP Agreement to be assigned to the Substitute Private Party.

78.1.5 Similarly, the PPP Agreement should not allow the Institution to assign its rights and obligations or even merely to cede its rights under the PPP Agreement. The Parties should, however, be aware that such assignment may occur by "operation of law" where an Institution's functions are vested by statute in another entity (for example, where a department or a business activity conducted by it is "corporatised" through the formation of a company or similar entity). Typically, such statutes will provide specifically that the contracts of the original Institution will be vested in the other entity as if the latter had entered into those contracts. The Private Party (and its funders) may seek to be protected against such "automatic" assignments in circumstances where the other entity is a new entity, based on a concern that the other entity may not have the capacity to meet the original Institution's financial obligations under the PPP Agreement. However, this concern is misplaced given that the assignment of institutional functions to another government entity will be accompanied by the allocation of the budget for those functions to the other entity (simply stated, "budget follows function"). In any event, contracting parties cannot avoid a mandatory statutory assignment of institutional functions. Therefore, if a Private Party seeks to be protected against such an assignment by requiring, for

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instance, a right to terminate on the basis that such assignment is a "deemed" Institution Default, this should be rejected.

78.1.6 Institutions sometimes wish to limit the ability of Lenders to transfer their rights in respect of the Project. However, Institutions should not attempt to interfere in the identity of Lenders.[499] If Institutions have particular concerns about issues, such as whether confidentiality will be maintained following a transfer, these can be dealt with in the specific clauses dealing with those issues.

Standard Clause

Assignment

(a) This PPP Agreement and any Project Document to which both the Institution and the Private Party are parties shall be binding on, and shall enure to the benefit of, them and their respective successors-in-title and permitted transferees and assigns.

(b) Save as expressly permitted hereunder and under the Direct Agreement, the Private Party shall not, without the prior written approval of the Institution, assign, cede, delegate, transfer or otherwise dispose of any right or obligation under this PPP Agreement or any Project Document to which it is a party to any other person.

(c) The Institution shall not assign, cede, delegate, transfer or otherwise dispose of any right or obligation under this PPP Agreement or Project Document to which it and the Private Party are parties to any other person, save with the prior written approval of the Private Party (such approval not to be unreasonably withheld or delayed) or to give effect to any mandatory requirement of any applicable law.

78.2 Subcontracting

78.2.1 The Institution may feel that it must exercise a large degree of control over all the subcontractors, whether at the first-tier or second-tier levels,

[499] Exempt Refinancings (which require prior notification to, but no approval from, the Institution) include any syndication, sell-down or grant of rights to co-finance by any Lenders to any Qualifying Financial Institutions.

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through so-called "collateral warranties" or direct undertakings from them. This applies to the *performance* of subcontracted Project Deliverables and the replacement of the subcontractors. On the other hand, the Private Party believes that since it is at risk for subcontractor defaults, it should be entitled to decide on the replacement of the subcontractors without interference by the Institution.

78.2.2 In general, any attempt by the Institution directly to control the *performance* by the subcontractors (whether at the first-tier or lower levels) of the subcontracted Project Deliverables is discouraged as it will dilute the level of risk transfer to the Private Party and, further, is unnecessary given the protections afforded the Parties under the PPP Agreement.

78.2.3 The Institution should ensure that all performance obligations in respect of the Project Deliverables are retained by the Private Party, *vis a vis* the Institution, and should look to the remedies it has against the Private Party under the PPP Agreement (for example, the Penalty Deduction regime) to ensure proper performance by the subcontractors. However, in some limited cases there may be special reasons why the Institution should have a degree of control over the performance of the subcontractors. For example, there may be public health and safety issues or national security concerns, such as in a hospital or prison project, or the Institution may have a statutory duty that it must perform.[500] In those cases, the degree of control must be reasonable.

78.2.4 On the other hand, the Institution should always be entitled to pre-approve the selection and appointment of all replacement first-tier

[500] The Institution should not, however, seek to control who the Private Party and its Subcontractors employ in the performance of the Services except where there are valid reasons for doing so. These should, however, be specified in the PPP Agreement and should be objectively measurable.

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Subcontractors, although it should have to do so with reference to objective and specified criteria.

78.2.5 These pre-approval criteria should be that the replacement Subcontractor:

78.2.5.1 has the appropriate technical and financial ability to perform the obligations of the original Subcontractor under the relevant Subcontract;

78.2.5.2 employs persons having appropriate qualifications, experience and technical competence; and

78.2.5.3 has sufficient resources available to it (including committed financial resources and contracts) to perform the obligations of the original Subcontractor under the relevant Subcontract.

The appointment of the replacement Subcontractor should also be conditional on the replacement Subcontractor having the necessary legal power and authority to become a party to the Subcontract, its directors not having any criminal convictions, it not having any outstanding tax liabilities (save for any such liability which is the subject of a *bona fide* dispute) and it meeting all specified empowerment criteria (which should at least be the same as for the original Subcontractor). The Institution should obtain appropriate assurances (such as warranties or similar undertakings) from the Private Party in this regard as a precondition for the grant of its approval.

78.2.6 Not Used.

78.2.7 The PPP Agreement should contain a procedure to be followed by the Parties when the Institution needs to consider any proposed replacement first-tier Subcontractor which it must approve. This procedure should not be one where the Institution's approval is deemed to be given if the

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Institution fails to respond within a particular time unless there are also provisions requiring the Private Party to give the Institution some notice after which the Institution has additional time (albeit a short period) to decide on whether or not it wishes to give its approval. Institutions should, however, be cognisant of the Private Party's programme for performing the Project Deliverables and should therefore ensure that its approvals are not unreasonably delayed, by making sufficient capacity available and implementing suitable arrangements. To facilitate this and comply with its obligations under the Regulatory Instruments, the Institution should ensure that the Project Officer designates an official to be the "project champion" and supervises all the subcontracting arrangements including the approval process.

78.3 Changes in Shareholding and Control

78.3.1 An Institution may be concerned about changes in the Shareholders and their respective shareholdings. If this is the case, then the Institution may seek to impose restrictions on the ability of the Shareholders to transfer their shareholdings in the Private Party or to otherwise change their shareholdings (for instance, through new subscriptions for shares). These restrictions can be effected indirectly (given that the Shareholders are not party to the PPP Agreement) by providing in the PPP Agreement for the penalty regime or default regime to be triggered if an unapproved change in shareholding occurs. The Shareholders may well object to these restrictions.

78.3.2 Imposing a restriction on the Shareholders' ability to change their interests (Equity and Shareholder Loans) in the Private Party is partly to prevent any person which the Institution thinks is unsuitable from becoming involved in the Project, partly because the Institution takes comfort from the commitment reflected by the original Shareholders

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continuing to keep their economic stake in the Project, partly because the law requires that the Private Party be selected in a fair and transparent process (which could be frustrated by allowing subsequent changes in the Shareholders).

78.3.3 Generally, the Institution's prior approval should not be required for any change in shareholding in the Private Party, unless such change effects a "change in control", nor for any change that effects the exit of a Shareholder whose involvement is no longer vital at the time of the exit (for example, a Shareholder related to the Construction Subcontractor who wishes to exit after construction completion and once Service Commencement has begun).

78.3.4 There is no generally accepted meaning of "change in control". Accordingly, an Institution will have to ensure that the PPP Agreement contains a definition of "change in control". In this regard, the Institution should bear in mind that it is not always possible to establish (even by undertaking a reasonably thorough due diligence) who "actually" owns (in the sense of "beneficially" or "benefiting from") shares in a company as the registration of a shareholding in the share register of a company could be effected in the name of a "nominee". Accordingly, the definition of "change in control" and the procedure for notifying all changes in shareholding should be directed to "beneficial" and not just "registered" ownership.

78.3.5 Institutions should also recognise that the Lenders have legitimate interests in limiting permitted changes of control of the Private Party and in requiring some commitments from the Shareholders (and their holding companies) to maintain their shareholdings and economic stake in the Project at least for some minimum period (usually not ending before they have invested all their Equity and Shareholder Loans in the Project). The

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Institution should not use its approval right in a way that will interfere with the ability of the Lenders to protect their legitimate concerns.

78.3.6 Not Used.

78.3.7 The consequences of a change of control that is not permitted should also be clearly specified in the PPP Agreement. Typically a change of control that is not effected in accordance with these requirements will be a Private Party Default and is considered to be so serious that it will entitle the Institution to terminate the PPP Agreement.[501]

78.3.8 The PPP Agreement may also include:

78.3.8.1 a detailed procedure that will enable the Institution to know when there has been a change in control. Thus it may not be enough simply to require the Private Party to give the Institution notice of an intended change. It might, for example, also be necessary for the Institution to require:

(a) the Private Party to insert provisions in its articles of association that refer to the change restrictions in the PPP Agreement and that require that all share certificates issued by the Company contain appropriate endorsements reflecting these transfer restrictions;

(b) that the share certificates of the Shareholders be held by a third party (in trust) so that they cannot be freely transferred by the Private Party. The Institution should bear in mind that the Lenders will typically take security over the Equity and the Shareholder Loans and may also therefore require that the share certificates relating to the Equity be deposited with

[501] See, for example, the provisions in the Standard Clauses in Part N:55.3.3 (*Termination for Private Party Default*).

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the Lenders' Agent (or any security company, trust or other entity appointed by the Lenders to hold their security for the Debt). If this is the case, then the Institution should not require that these share certificates be deposited with it or its nominee and should instead (if this will provide comfort for the Institution) agree with the Lenders that the Lenders' Agent (or the security company, trust or other entity, as the case may be) will notify the Institution of any changes in the deposit arrangements and any release of such certificates. This agreement may be incorporated in the Direct Agreement, which may also include provision for the Lenders' Agent (or the security company, trust or other entity, as the case may be) to hand over the share certificates to the Institution when the Debt is discharged; and/or

(c) for the Institution to be entitled to require from time to time that it be given copies of or access to certain documents (such as the Private Party's share register) to satisfy itself that there has been no change in control that it has not approved; and

78.3.8.2 a detailed procedure for the giving of the necessary approval by the Institution.

Standard Definitions

*"**Change in Control**" means any change whatsoever in Control whether effected directly or indirectly;*

*"**Control**" means, in relation to any entity, the ability directly or indirectly to direct or cause the direction of the votes attaching to the majority of its issued shares or interests carrying voting rights, or to appoint or remove or cause the appointment or removal of any directors (or equivalent officials) or those of its directors (or equivalent officials) holding the*

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majority of the voting rights on its board of directors (or equivalent body).

Standard Clause

Changes in Control

(a) *For the duration of the Project Term [(save as otherwise provided in Clause (b))], the Private Party shall procure that there is no Change in Control in the Private Party without the prior written approval of the Institution.*

(b) *[[Prior to the expiry of a period of [x] months commencing on the Service Commencement Date], the Private Party shall procure that there is no sale, assignment, cession, transfer, exchange, renunciation or other disposal of the whole or any part of the Equity and/or the Shareholder Loans, nor any dilution of the Equity, of [x] without the prior written approval of the Institution.[502]]*

(c) *The Private Party shall procure that for the duration of [period,] [subject to the Lenders' rights in respect of any security held by them (or any agent acting on their behalf, or any security company, trust or other entity holding any security in respect of the Debt for the benefit of the Lenders)] there is no sale, assignment, cession, transfer, exchange, renunciation or other disposal (at any time) of the whole or any part of the Equity and/or the Shareholder Loans.*

79 THIRD PARTIES

79.1 It is important for the Parties to remember that a written contract only binds those people who have signed the contract. Generally therefore, everyone who should be bound by a contract must sign it, after obtaining all necessary approvals.

79.2 As such, no provisions should be included in any contract which are intended to impose obligations on any third parties who are not parties to the contract.

[502] This Standard Clause relates to a Shareholder who will not play a key role in the Project after the "lock-in" period (or is a Shareholder of an entity, such as a Subcontractor, who will not play a key role). The length of the lock-in period will depend on the Project concerned.

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80 TAXATION

80.1 The general principle for PPP Agreements should be that the Private Party is liable for any taxation applicable to its income or activities, this risk not being transferred to the Institution.

80.2 Generally, therefore, the PPP Agreement should not provide that the Institution must pay more if the Private Party does not receive the amounts which it expected because of the introduction of additional or new taxes, particularly withholding taxes (this provision is often called a "gross-up" clause). The Institution does not control the tax policies or laws in Pakistan, and there is no reason for the risk of changes in those tax policies or laws to be borne by it.

80.3 An exception to this may arise if the Institution does control changes in tax policies or laws, or where there are unforeseeable changes in tax policies or laws which specifically discriminate against the Private Party so that it is dealt with differently from other persons carrying on similar activities. [503]

80.4 Private Parties may feel that they should be entitled to some additional payments because under their agreements with their funders they must increase their payments to their funders in instances where there are changes in taxation affecting the amounts the funders receive on their loans. However, the positions of the funders and of the Private Party are not the same in this regard, and risks arising from unforeseeable changes in tax law that apply generally should be borne by the Private Party. Risks arising from changes that are discriminatory and specific to the Private Party should be dealt with in the PPP Agreement provisions dealing with unforeseeable discriminatory government conduct.

[503] See Part K:49 (*Unforeseeable Discriminatory Government Conduct and Variations: Unforeseeable Discriminatory Government Conduct*).

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80.5 The PPP Agreement should expressly state whether amounts payable by either Party under the PPP Agreement are exclusive or inclusive of GST .

81 DISPUTE RESOLUTION

81.1 General

81.1.1 The PPP Agreement must specify a procedure for handling disputes under the terms of the PPP Agreement.

81.1.2 It is often argued by the Private Party (and particularly its funders) that resolving disputes under a contract by means of normal litigation processes (that is, through the courts) is too slow, too expensive and sometimes even "unreliable" as the courts may lack the expertise necessary to adjudicate the technical and financial complexities of PPP Agreements. They usually argue therefore that arbitration by specified arbitrators is the best dispute resolution regime for PPP Agreements.[504]

81.1.3 However, these arguments are not sustainable for the following reasons. There is no inherent or automatic benefit in arbitration since arbitration is not necessarily quicker or cheaper than litigation through the courts. The rules of court permit the appointment of technical and financial experts to assist judges in regard to matters that require expert consideration. The private negotiated selection of arbitrators does not ensure the selection of the most able persons for such appointments and, in so far as such selection is not an open process or otherwise subject to the regulatory checks inherent in the process of judicial selection, may even be tainted by claims of nepotism. But the most compelling reason for the preference for curial adjudication over arbitration is the need to build up a

[504] If arbitration is selected for the resolution of any disputes under a contract, then the parties would also consider whether the Pakistani Arbitration Act, 1940, or any international regime for arbitration of commercial disputes, such as the Rules of Arbitration of the International Chamber of Commerce, should apply to the arbitration.

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substantial legal precedent base for the interpretation and enforcement of PPP Agreements, to provide the courts with the opportunity to grow the expertise required to deal with the complexities of PPP Agreements and to promote a measure of transparency regarding the interpretation and enforcement of PPP Agreements.

81.1.4 Accordingly, the prescribed approach for disputes arising in connection with PPP Agreements is for these to be settled ultimately through the courts, except in the case of any specific categories of dispute requiring fast-track dispute resolution by expert adjudicators. Further, alternative forms of dispute resolution processes such as informal conciliation must first be attempted.

81.1.5 Alternative forms of dispute resolution endeavour to have the dispute resolved "amicably", that is by agreement between the affected parties rather than by the imposition of some external decision. The prescribed alternative form of dispute resolution involves informal conciliation through internal referrals up a ladder of increasingly senior levels of the Parties (all the way up to the chief executive officer or board of directors (or equivalent authority)).[505] If these informal attempts fail, then the dispute should be decided by means of litigation in the courts, save in the case of disputes for which fast-track dispute resolution is specified.

81.1.6 A fast-track dispute resolution process is included in the PPP Agreement to deal with urgent issues which cannot be delayed by, among other things, the wait for a court date or with clear "non-legal" issues that do not justify lengthy and expensive curial procedures to be resolved.

[505] Another form of dispute resolution not favoured in this Standardisation is mediation. This is where a neutral third party attempts to help the disputing parties to resolve their dispute but has no power to impose a binding solution. Mediation is not preferred because it is not likely to produce any better results than internal referral.

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81.1.7 Sometimes the dispute between the Institution and the Private Party involves issues which are also matters of dispute between the Private Party and one or more of its Subcontractors or another third party. If common issues are involved, it may seem practical to join all the disputing parties in one proceeding. Joinder of a third party is also unavoidable (by operation of law) in curial proceedings where that third party is a "necessary party", that is, it has a direct and substantial interest in any order that might be made or where such order cannot be carried into effect without prejudice to that third party.[506] Where a third party is not a "necessary party", joinder can be effected (so-called joinder of "proposer party") with the consent of the primary parties to the dispute, but this is not the best way to proceed in PPPs. For the Institution, joinder of a Subcontractor who is not a "necessary party" to the dispute will increase the time, effort and cost of resolving its dispute with the Private Party.[507] Accordingly, the prescribed approach is for the Institution not to agree upfront to joinder of parties (subject to applicable law) but rather to consider this issue only where the dispute arises and then to take legal advice about the benefits of joinder.

81.1.8 Private Parties sometimes endeavour to include disputes between them and the Institution under the list of Relief Events provided for in the PPP Agreement so that they do not have to continue performing the Project Deliverables until the disputes are resolved. This issue arises especially during the construction phase. This should be resisted. The Private Party (and the Subcontractors) should not be permitted to stop performing the Project Deliverables simply because a dispute has arisen. The design, engineering and construction contractors should be very

[506] Such joinder of necessity is not dependent on the discretion of the court, which is duty bound (by common law and the rules of court) not to proceed without the joinder of the third party unless there is clear evidence that the third party has waived its rights to joinder.

[507] In addition, given the allocation of subcontractor risk to the Private Party, the Institution should avoid becoming caught up in the Private Party's disputes with its Subcontractors.

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familiar, through the work which they ordinarily do, with these principles, and should know how to organise themselves so that they can continue as far as possible with their work.

81.1.9 The Private Party must be under an obligation to continue with the Project Deliverables in accordance with the PPP Agreement while any dispute is unresolved, even if this involves building or covering over construction works which may need rebuilding or opening up if the dispute is resolved in the Private Party's favour. The Private Party must rely on the dispute resolution procedure providing adequate compensation to it if the dispute is resolved in its favour.

81.1.10 The Institution should recognise that if the dispute is resolved in the Private Party's favour, the Institution will typically be liable for the Private Party's costs. These could include any extra costs incurred in rebuilding (such as staff costs and materials costs) and any resulting costs incurred by the Private Party if a delay to commencement of the Services results.

Standard Clause

<u>Dispute Resolution</u>

(a) <u>Referable Disputes</u>

The provisions of this Clause [x] (Dispute Resolution) shall, save where expressly provided otherwise, apply to any dispute arising in relation to or in connection with any aspect of this PPP Agreement between the Parties.

(b) <u>Internal Referral</u>

(i) If a dispute arises in relation to any aspect of this PPP Agreement, the Parties shall attempt in good faith to come to an agreement in relation to the disputed matter, in accordance with the following informal process:

(aa) all disputes shall first be referred to a meeting of the [liaison officers or other designated executives from

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each Party who are actively involved in the Project, and have sufficient authority to be able (if necessary with consultation back to their respective organisations) to resolve it]; and

(bb) if the Parties have been unable to resolve the dispute within [x] days of referral to [the persons specified in Clause (b)(i)(aa)], either Party may refer the dispute for a decision by the [Accounting Officer / Accounting Authority of the Institution] and the [Chief Executive Officer or equivalent officer] of the Private Party.

(ii) In attempting to resolve the dispute in accordance with the provisions of this Clause (b), the Parties shall (and shall procure that their employees and representatives shall) use reasonable endeavours to resolve such dispute without delay by negotiations or any other informal procedure which the relevant representatives may adopt. Those attempts shall be conducted in good faith in an effort to resolve the dispute without necessity for formal proceedings.

(iii) Any dispute which has not been resolved by the representatives contemplated in Clause (b)(i)(bb) within [x] days of the dispute being referred to them (or any longer period agreed between the Parties) shall be treated as a dispute in respect of which informal resolution has failed.

(c) <u>Performance to Continue</u>

No reference of any dispute to any resolution process in terms of this Clause shall relieve either Party from any liability for the due and punctual performance of its obligations under this PPP Agreement.

(d) <u>Litigation</u>

(i) Save where any dispute has been expressly referred for determination in terms of Clause [x] (Fast-Track Dispute Resolution), if informal resolution of any dispute has failed, then the dispute may be referred to litigation in the courts by either Party.

(ii) Neither Party is limited in any proceedings before the court to the information, evidence or arguments used in the informal attempts to resolve the dispute.

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81.2 Fast-track Dispute Resolution

81.2.1 In many contracts, the parties may sometimes wish to have certain disputes determined by independent experts. For example, the Parties may agree that disputes concerning the calculation of any Refinancing Gains, or the application of any inflation-indexation mechanism, or the application of the economic test to determine whether the proceeds of the material damage insurances should be applied to reinstate the Project, be resolved on a fast-track basis by an independent financial expert.

81.2.2 The prescribed position is that any such independent expert should be appointed by agreement between the Parties in the PPP Agreement itself and not by either of the Parties alone. If the Parties cannot agree on the identity of that expert, then provision should be made for an appropriate third party to make the appointment. The relevant clause should clearly set out the procedure for the appointment of the expert and the terms of the expert's mandate. Depending on the nature of the project there may well be a need for the appointment of several Independent Experts. The number of Independent Experts should be determined on a project-by-project basis. Where there is more than one Independent Expert, the PPP Agreement should incorporate a Schedule allocating the appropriate Independent Expert to each dispute or category of disputes. Alternatively, every provision in the PPP Agreement expressly referring a matter for Fast-track Dispute Resolution should also expressly identify the appropriate Independent Expert. Provision should also be made for payment of the costs of each Independent Expert.

81.2.3 One of the practical issues that needs to be addressed in the selection of an appropriate Independent Expert for any dispute or category of disputes, is that given the long-term nature of PPPs the selected expert may not always be available, whether through resignation, death,

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insolvency, dissolution or otherwise or, for instance, where because of changes in circumstances after the Project has commenced that expert has developed a conflict of interest thereby creating uncertainties regarding its impartiality. Accordingly, the PPP Agreement must make provision for the expeditious appointment of alternates in cases of unavailability and potential conflicts of interest. To save time, the PPP Agreement may specify a "panel" of experts for appointment as the Independent Expert and if so should specify a procedure for the selection of the Independent Expert from that panel. That procedure could include a rotational system providing for the periodic rotation of the experts on the panel, so that at the commencement of each period, the expert designated in the rotation schedule shall automatically be appointed as the Independent Expert for that period, unless it is unavailable or disqualified, in which case the next expert on the schedule will be the Independent Expert, and so forth.

81.2.4 The prescribed position is also that the Independent Expert's determination will be final and binding on the Parties. However, where the Parties wish to make provision for the Independent Expert's decision, if disputed, to be "appealable", then such dispute should fall into and be dealt with in the ordinary dispute resolution clause with no special mechanism needing to be created.

Standard Clause

Fast-track Dispute Resolution

(a) Disputes expressly referred for determination pursuant to this Clause [x] (Fast-track Dispute Resolution) shall be determined by the [relevant][508] Independent Expert.

(b) Within [five] Business Days after a dispute has been referred by either Party to the appropriate Independent Expert, the Independent Expert shall require the Parties to submit in writing their respective arguments. The Independent Expert shall, in

[508] See Section 81.2.2 and Section 81.2.3.

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his/her absolute discretion, consider whether a hearing is necessary in order to resolve the dispute.

(c) *It shall be entirely within the power and competence of the Independent Expert to decide upon any matters related to the proper preparation of the dispute for hearing and in that regard the Independent Expert shall direct the Parties accordingly.*

(d) *The Independent Expert shall set the date for the hearing, choose the venue (which must be a venue in Pakistan) for the hearing and determine all matters regarding any aspect of the hearing. Moreover, the Independent Expert can decide whether at the hearing the Parties are to give oral evidence or confine themselves to presenting their cases in writing or by some other appropriate procedure. In this regard, the Independent Expert must be guided by considerations of fairness, the cost-effective resolution of the dispute, and the need to resolve the dispute quickly.*

(e) *The Independent Expert shall provide both Parties with his/her written decision on the dispute, within [20 (twenty)] Business Days of the referral (or such other period as the Parties may agree after the referral). The Independent Expert shall give his/her reasons for the award, if so requested by either Party.*

(f) *The Independent Expert's costs of any referral shall be borne as the Independent Expert shall specify or, if not specified, equally by the Parties. Each Party shall bear its own costs arising out of the referral, including its legal costs and the costs and expenses of any witnesses.*

(g) *The Independent Expert shall act impartially and may take the initiative in ascertaining the facts and the law. The Independent Expert need not strictly observe the principles of law and may decide the matter submitted to him/her in accordance with what he/she considers equitable in the circumstances.*

(h) *Should the need arise for either Party to seek interim or temporary relief before the adjudication is finalised, that Party may apply to the Civil Court having jurisdiction in the matter for interlocutory relief.*

(i) *The proceedings shall be confidential and all information, data or documentation disclosed or delivered by either Party to the Independent Expert in consequence of or in connection with his/her appointment as Independent Expert shall be treated as confidential. Neither the Parties nor the Independent Expert shall, save as permitted by Clause [x] (Confidentiality) of this PPP Agreement, disclose to any person any such information, data or documentation unless the Parties otherwise agree in*

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writing, and all such information, data or documentation shall remain the property of the Party disclosing or delivering the same and all copies shall be returned to such Party on completion of the Independent Expert's work.

(j) The Independent Expert is not liable for anything done or omitted in the discharge or purported discharge of his/her functions as Independent Expert, unless the act or omission is grossly negligent or in bad faith. Any employee or agent of the Independent Expert is similarly protected from liability.

(k) Should any Party fail to co-operate with the Independent Expert with the result that in the view of the Independent Expert such default or omission prejudices the adjudication process, then the Independent Expert can either:

(i) give that Party written notice that unless it remedies the default or omission within a given time, it will forfeit the right to continue to participate in the adjudication; or

(ii) warn the Party in writing that its default or omission may make it liable to a punitive order of costs, and the Parties hereby acknowledge their obligation to pay such punitive costs as a debt.

(l) The Independent Expert shall be deemed not to be an arbitrator but shall render his/her decision as an expert and the provisions of the Arbitration Act, 1940 and any other law relating to arbitration shall not apply to the Independent Expert or his/her determination or the procedure by which he/she reaches his/her determination. The Independent Expert's decision shall be final and binding on the Parties.

82 GOVERNING LAW AND JURISDICTION

This will be a relatively standard provision.

Standard Clause

Governing Law and Jurisdiction

(a) This PPP Agreement shall be governed by and construed in accordance with the laws of the Islamic Republic of Pakistan.

(b) Subject to the provisions of Clause [x] (Fast-track Dispute Resolution), each Party agrees that the Civil Court of [the District where the Project is to be

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performed[509]]shall have exclusive jurisdiction to hear and decide any application, action, suit, proceeding or dispute in connection with this PPP Agreement, and irrevocably submits to the jurisdiction of the said Civil Court.

83 AMENDMENTS[510]

This will be a relatively standard provision.

Standard Clause

Amendments

No provision of this PPP Agreement (including, without limitation, the provisions of this Clause) may be amended, substituted or otherwise varied, and no provision may be added to or incorporated in this PPP Agreement, except (in any such case) by an agreement in writing signed by the duly authorised representatives of the Parties.

84 WAIVER

This will be a relatively standard provision.

Standard Clause

Waiver

*(a) Any relaxation, indulgence or delay (together "**Indulgence**") by either Party in exercising, or any failure by either Party to exercise, any right under this PPP Agreement shall not be construed as a waiver of that right and shall not affect the ability of that Party subsequently to exercise that right or to pursue any remedy, nor shall any Indulgence constitute a waiver of any other right (whether against that Party or any other person).*

(b) The waiver of any right under this PPP Agreement shall be binding on the waiving Party only to the extent that the waiver has been reduced to writing and signed by the duly authorized representative(s) of the waiving Party.

85 ENTIRE PPP AGREEMENT

This will be a relatively standard provision.

Standard Clause

[509] In some cases, the Project may span the territorial jurisdiction of more than one Districts, e.g. a toll road or train project. In that case, the District where the headquarters of the Institution are located should be chosen.

[510] Amendments to a PPP Agreement may only be executed by the accounting officer or accounting authority, as the case may be, of the relevant Institution (see [PPP Law / PPP Policy]). Further, any material amendment will require the approval of the relevant Treasury.

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Entire PPP Agreement

(a) Except where expressly provided otherwise in this PPP Agreement, this PPP Agreement constitutes the entire agreement between the Parties in connection with its subject matter and supersedes all prior representations, communications, negotiations and understandings concerning the subject matter of this PPP Agreement.[511]

(b) Each of the Parties acknowledges that:

(i) it does not enter into this PPP Agreement on the basis of and does not rely, and has not relied, upon any statement or representation (whether negligent or innocent) or warranty or other provision (in any case whether oral, written, express or implied) made or agreed to by any person (whether a Party to this PPP Agreement or not) except those expressly contained in or referred to in this PPP Agreement, and the only remedy available in respect of any misrepresentation or untrue statement made to it shall be a remedy available under this PPP Agreement; and

(ii) this Clause shall not apply to any statement, representation or warranty made fraudulently, or to any provision of this PPP Agreement which was induced by fraud, for which the remedies available shall be all those available under the law governing this PPP Agreement.

86 CONFLICTS WITH OTHER CONTRACTS

86.1 Each project will require several contracts in addition to the PPP Agreement and the Direct Agreement, for example, a Construction Subcontract, an Operations Subcontract and several second-tier subcontracts.[512]

86.2 The parties to these contracts will not all be the same. Thus the Institution is only likely to be a party to the PPP Agreement and the Direct Agreement. The Private Party will be a party to some but not all of the contracts, for example, it will not be a party to the second-tier subcontracts. The PPP Agreement must identify all the contracts required for the Private Party to perform the Project Deliverables (these are referred to herein as the "**Project Documents**"). The PPP Agreement must also include a simple provision setting out the priority in

[511] The undertakings of the Private Party in the PPP Agreement should, to the extent that they are different from those in its bid proposal, be an "improvement" on the bid proposal for the Institution in terms of value for money, affordability and risk transfer. Accordingly, from a "procurement" point of view, the reliance on the PPP Agreement as reflecting the true agreement between the Parties is appropriate. Further, the PPP Agreement, if properly drafted, should reflect all matters raised in the RFP and all commitments made by the Private Party in its bid proposal (save as improved on in the negotiations).

[512] See also Part B:4 (*Project Documents and Project Deliverables: Project Documents*).

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which the various Project Documents will rank if there is any conflict between provisions in them. The PPP Agreement is the primary contract and should prevail over other contracts in respect of the Project.

Standard Clause

Conflicts with other contracts

In the event of any conflict between this PPP Agreement and any Project Document, the provisions of this PPP Agreement will prevail. In the event of any conflict between any of the Project Documents, the following order of precedence will apply, with agreements listed earlier in this list prevailing over those listed later:

[Insert the ranking of the Project Documents]

87 SEVERABILITY

It is customary in Pakistan for contracts to include a clause providing that if there are provisions in the contract which become invalid, illegal or unenforceable, they can be excluded from the contract, while the rest of the contract continues to stand. It should be understood that, while these clauses do no harm, they are no guarantee that the intentions expressed in them will apply. However, the question whether an invalid, illegal or unenforceable clause is 'severable' to salvage the remaining agreement while retaining intact the commercial arrangements under the agreement will largely be decided on a case-by-case basis. The courts are not bound by what the parties have agreed.

Standard Clause

Severability

Whenever possible, each provision of this PPP Agreement shall be interpreted in a manner which makes it effective and valid under applicable law, but if any provision of this PPP Agreement is held to be illegal, invalid or unenforceable under applicable law, that illegality, invalidity or unenforceability shall not affect the other provisions of this PPP Agreement, all of which shall remain in full force.

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88 COUNTERPARTS

Wherever possible, both Parties to the PPP Agreement should sign the same document at the same time and in the same place. However, if this is not possible, then each Party may sign separate identical copies of the PPP Agreement, either in different places at the same time, or even at different times and places. These separate copies are commonly referred to as "counterparts".

Standard Clause

Counterparts

This PPP Agreement may be executed in any number of identical counterparts, all of which when taken together shall constitute one agreement. Any single counterpart or a set of counterparts taken together which, in either case, are executed by the Parties shall constitute a full original of this PPP Agreement for all purposes.

89 NOTICES AND LEGAL SERVICE

89.1 The PPP Agreement should include a clause which sets out the addresses chosen by the Parties where notices and other communications (including, without limitation, any approval, consent, demand, query or request) contemplated in the PPP Agreement may be sent or delivered. The Clause should allow for different ways of giving those notices, for example, by registered post, hand delivery, facsimile or e-mail.

89.2 The Clause should set out the procedure to be followed if a Party wishes to change its chosen address.

89.3 If there is a dispute between parties to a contract resulting in them becoming involved in litigation, then they will have to deliver various legal documents to each other. Some of these must be delivered by an official of the Court. The formal term for delivery of all of these documents is "service". The law allows for these legal documents to be served at an address chosen by the relevant party in the contract even if that party is not present at that address or has left that address. This is intended to assist parties who might otherwise

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have had great difficulty in actually locating the party with whom they are in dispute. Because of the rules relating to service, it is prescribed that any address for service must be a physical address in Pakistan.

Standard Clause

Notices and Legal Service

(a) All notices and any other communications whatsoever (including, without limitation, any approval, consent, demand, query or request) by either Party in terms of this PPP Agreement or relating to it shall be given in writing and sent by registered post, or delivered by hand, or transmitted by facsimile or electronic mail to the recipient Party at its relevant address set out below:

(i) if to the [Institution], at:

Address:

Postal address:

Facsimile number:

Electronic mail address:

[marked for the attention of ………………..]

(ii) if to the Private Party, at:

Address:

Postal address:

Facsimile number:

Electronic mail address:

[marked for the attention of ………………..]

(b) Either Party may, by written notice to the other Party, change any of the addresses at which or the designated person for whose attention those notices or other communications are to be given, provided always that such address (except for Electronic mail address) shall be a place in Pakistan.

(c) Any notice or other communication given by any Party to the other Party which:

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(i) is sent by registered post to the addressee at its specified address shall be rebuttably presumed to have been received by the addressee on the [7th (seventh)] day after the date of posting; or

(ii) is delivered by hand to the addressee during the normal business hours of the addressee at its specified address shall be rebuttably presumed to have been received by the addressee at the time of delivery; or

(iii) is transmitted by facsimile to the addressee during the normal business hours of the addressee at its specified facsimile number shall be rebuttably presumed to have been received by the addressee on the date of transmission as indicated on the sender's facsimile transmission report; or

(iv) is transmitted by electronic mail to the addressee during the normal business hours of the addressee at its specified electronic mail address shall be rebuttably presumed to have been received by the addressee on the date of transmission as reflected on the sender's electronic mail records.

(d) The previous provisions of this Clause shall not invalidate any notice or other communication actually given and received otherwise than as described in those provisions.

(e) The Parties choose their respective physical addresses in Clause (a) as their respective addresses at which all documents relating to any legal proceedings to which they are a party may be served.

90 CONFIDENTIALITY

90.1 The prescribed approach is that as much information in the PPP Agreement or as provided in terms of it as possible be placed in the public domain and only information which is commercially sensitive or sensitive for public interest reasons should be protected and excluded.

90.2 The Parties may wish to protect the confidentiality of that sensitive information provided by either of them to the other or set out in the PPP Agreement. Two important points should be kept in mind:

90.2.1 under the Freedom of Information Ordinance, 2002 the Institution is obliged to make available a great deal of information which it holds to any person who asks for it. That Ordinance does allow some

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information, including commercially sensitive information, to be protected and not disclosed. Although the Parties may want to include a Clause in the PPP Agreement obliging each of them to respect and protect the confidentiality of the information provided by the other Party, that provision cannot prevail over the obligations of the respective Parties under the said Ordinance; and

90.2.2 not all information provided by one Party to the other is confidential and as such the Parties should not try to extend confidentiality protections to information which does not warrant these protections. The Parties should therefore define what constitutes confidential information in a realistic and objective way. The test for whether information should be protected as confidential should be whether the disclosure would cause real prejudice to the interests (legal and/or commercial) of the relevant Party.

90.3 Neither Party should be penalised if confidential information is disclosed to any third party in any way that is not its fault or that does not constitute a breach by it of its obligations.

90.4 Securities exchanges and some other regulatory bodies have publicity requirements that must be complied with by entities of which they are in charge. These types of disclosure requirements should be taken into account in agreeing upon the confidentiality obligations in the PPP Agreement, and should not be prohibited or restricted to an extent that prevents the relevant Party from complying with its obligations to the relevant securities exchange or other regulator.

Standard Clause

Confidentiality

*(a) For purposes of this Clause, "**Confidential Information**" means any information which is agreed by the Parties at the time of conclusion of this PPP Agreement or before it is provided to the recipient Party to be [commercially sensitive] [sensitive on grounds of …….].*

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(b) Each Party shall keep all Confidential Information of the other Party confidential while this PPP Agreement remains in force [and for a period of [x] years after it terminates for any reason]. Each Party shall also use reasonable endeavours to prevent its employees, agents and Subcontractors from making any disclosure to any person of any Confidential Information of the other Party while this PPP Agreement remains in force [and for a period of [x] years after it terminates for any reason].

(c) Clause (b) shall not apply to:

(i) any disclosure of information that is reasonably required by persons engaged in the performance of the restricted Party's obligations under this PPP Agreement;

(ii) any matter which a Party can reasonably demonstrate is already generally available and in the public domain otherwise than as a result of a breach of this Clause;

(iii) any disclosure as part of any attempt to resolve a dispute in accordance with Clause [x] (Dispute Resolution) or Clause [x] (Fast-track Dispute Resolution);

(iv) any disclosure which is required by any law (including any order of a Court of competent jurisdiction), or the rules of any stock exchange or governmental or regulatory authority having the force of law;

(v) any disclosure of information that is already lawfully in the possession of the receiving Party prior its disclosure by the disclosing Party;

(vi) any provision of information to the advisors of the receiving Party, or to any funders or potential funders, but in the latter case, only to the extent reasonably necessary to enable a decision to be taken on whether that potential funder will become a funder;

(vii) any disclosure by the Institution of information relating to the design, construction, operation and maintenance of the Project and any other information that may be reasonably required for the purpose of retendering of this PPP Agreement in accordance with Clause [x];[513] *or*

(viii) any disclosure of information by the Institution to any Responsible Authority.

[513] This is the Clause dealing with retendering in Part N:60 (*Termination: Compensation on Termination for Private Party Default*).

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(d) The disclosures permitted under Clauses (c) (vi), (vii) or (viii) may only be made subject to obtaining appropriate confidentiality restrictions consistent with the provisions of this Clause from the intended recipients.

91 SIGNATURE FOR INSTITUTIONS

91.1 Institutions must comply with any applicable legal restrictions on signing of the PPP Agreements on behalf of the Institutions by anyone other than their Accounting Officers or Accounting Authorities, as the case may be.

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