Drafting & Negotiating PPP Contracts

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Presentation Outline

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Protocols

- Let me start by commending Mrs Dianne Okoko, the Principal Partner of Marcus-Okoko & Co for this capacity-building initiative – Marcus-Okoko Associate Development Program (MO ADP)
- This is the last of the three lectures that she 'directed' me to deliver to her Associates and interns:
  - ✓ Understanding Clauses in Specific Contracts: 4 August, 2021
  - ✓ Counsel in Arbitration: 3 November, 2021
  - ✓ Drafting & Negotiating PPP Contracts: 13 January, 2022
- I must thank her for this opportunity to share my thoughts and experience in these diverse areas.

William James, *The Varieties of Religious Experience,* Harvard University, March 1902.

'Ideas efficacious at sometimes and in some human surroundings are not so at other times and elsewhere'.

Introduction

- Globally, Public-Private Partnerships (PPPs) are increasingly becoming recognised as a means of procuring infrastructure, indicating a paradigm shift in the relationship between the private and public sectors – from owner/operator to regulator
- Indeed, the boundaries between the public and private sectors are becoming blurred as revealed by commercialisation and privatisation
- The monopolistic tendencies in certain sectors – historically all infrastructure sectors – power, gas, water, telecoms, transport, etc were thought to exhibit monopolistic characteristics and therefore, better provided by the public sector only

…..Introduction

- Similarly it has become obvious that governments do not have the resources to finance the provision of these services
- In many countries, budgetary constraints and general paucity of public funds impede the development of large scale and often capital intensive infrastructure projects and so it has become fashionable to involve the private sector in infrastructure development in order to alleviate fiscal constraints and bridge infrastructure gaps, within the shortest time possible
- Added to this, is the fact that such collaborations enable the public sector to step-down most of the risks that come with executing these infrastructure projects by passing them on to the private sector.

.....Introduction

- PPPs are normally very complex arrangements, which comprise several parties, models and contracts.
- There can be a public authority which identifies the need for infrastructure and decides that the project is one suitable for financing through PPP; and a private sector participant, usually a Special Purpose Vehicle (SPV) who executes the Public-Private Partnership (PPP) project by providing the required services.
- There can also be Unsolicited Proposals - project proponent submits proposals
- Who carries out the Feasibility Study is dependent on who initiates
- Also, there is usually a Project Agreement (Concession Agreement), which defines the roles, responsibilities and obligations of the principal participants in the infrastructure project.

.....Introduction

- This Project Agreement (or Concession Agreement) is at the heart of a PPP transaction because it is the major contract around which a chain of other equally relevant contracts and sub-contracts revolve.
- The complex nature of PPP transactions demand that extreme care and consideration goes into the drafting and negotiating process of not only the major contract but also the associated contracts and sub-contracts to ensure that they are aligned
- Attention should be given to detail and care should also be taken to ensure that there is no mismatch between the major contract and the other contracts on the one hand and amongst the other contracts on the other – eg what amounts to *force majeure*, dispute resolution clause, governing law, etc

.....Introduction

- Infrastructure services are critical inputs in the provisions of goods and services and significantly affect the productivity, cost and competitiveness of the economy.
- Policy decisions regarding their provision and sector development have ramifications throughout the economy – developed and developing economies
- The nature of the partnership is determined by the type of infrastructure – hard economic infrastructure or social economic infrastructure.
- Another classification is between 'green field' (new infrastructure eg Monorail in PH) and 'brown field' (existing infrastructure eg Port Terminals, Abuja International Airport, Ajaokuta Steel Rolling Mill, Lagos-Ibadan Road).
- In this presentation, we will focus on drafting and negotiating PPP contracts.

What is PPP?

- Public/Private Partnerships (PPPs) are contractual arrangements between a public entity and a private party, whereby the private party performs part of a government institution's service delivery function and/or acquires the use of government property for commercial purposes, and assumes the associated risks.
- In return the private entity receives a benefit/financial remuneration according to predefined performance criteria (eg Lagos-Ibadan Expressway).
- The PPP arrangement is meant to ensure sustainable investment in infrastructure and infrastructure services as well as contribute to soundness in public finance

.....What is PPP?

- This dramatic move to private participation in infrastructure reflects the search for improved governance mechanisms that allocate risks to those best able to bear, control and manage them and realization that resources exist in the private sector for such projects
- Capacity building in project planning, co-ordination and monitoring of PPP projects among public officers is an essential element required to strengthen the implementation capacity.
- According to the International Monetary Fund (IMF), a PPP is a contractual arrangement where the private sector supplies infrastructure assets and services that traditionally have been provided by the government

…..What is PPP?

- Thus, with PPPs, the key principle is that government, ministries, departments and agencies are transmuted from being owners and operators of assets into the buyers of services from the private sector or regulators of services, with the private sector assuming the position of long-term providers of service which they deliver by taking charge of the design, construction, financing, maintenance the operation of the assets
- The nature of the partnership is also determined by the type of infrastructure – **hard economic infrastructure** (roads, motorways, bridges, ports, railways, airport, power, telecommunications) or **social economic infrastructure** (export assistance, technology transfer and vocation training).

……What is PPP

- It can also be **hard social infrastructure** (hospitals, schools, water supply, housing, sewerage, prisons) or **soft social infrastructure** (social security, community services and environmental agencies).
- The entire Public-Private Partnership procurement process may be divided into four main phases; i.e.

✓ the planning and feasibility phase,
✓ the bidding and negotiation phase,
✓ the construction phase,
✓ the operation phase and
✓ possibly the transfer of or re-negotiation phase.

Principal Parties to a PPP Contract

- A Public-Private Partnership is an organisational framework that comprises a number of parties who have converged to promote infrastructure investment.
- **The parties to an infrastructure project may differ remarkably depending on the infrastructure sector, the modality of private sector participation and the project funding arrangements.**
- No two infrastructure projects are the same.
- Each one is unique and so, the parties to each project would be determined by its specific requirements and peculiarities.
- Regardless, in drafting a PPP contract, it must be borne in mind that a typical infrastructure project arrangement would generally include the following parties:

…..Principal Parties to a PPP Contract

- the public authority (ministries, departments, agencies and corporations)
- Sector regulators
- the private sector - sponsors
- the financier(s)
- the sub-contractors;
- Advisers - financial, technical and legal, Insurance advisers, rating agencies and underwriters

.....Public Authority

In deciding whether PPP is a suitable procurement option for public infrastructure and services, the **Public Authority** will be guided by certain key principles, which include:

- ✓ achieving the best value for money – price and quality;
- ✓ public interest;
- ✓ the best risk allocation;
- ✓ verifiable standards of service to be provided based on output requirements;
- ✓ transparency and openness before, during and after the procurement process;
- ✓ effective competition amongst bidders so as to maximise the benefits of private sector participation in infrastructure development;
- ✓ capacity of the authority to manage the project facility and partner with the private sector on an equal basis;
- ✓ effective engagement with the market through a clear communication of the objectives of the infrastructure project.

Financial Sources

- Conventionally, Public-Private Partnerships projects have been funded partly by debt and partly by equity investment but today, there are a number of other funding sources which are increasingly being used to finance infrastructure projects.
- The various financial sources are discussed below:

✓ Equity capital
✓ Commercial Loans
✓ Subordinated Loans – Mezzanine capital
✓ Institutional Investors like the Infrastructure Bank, insurance companies
✓ Capital Market

.....Financial Sources

- ✓ Islamic Banking
- ✓ Financing by International Financial Institutions like the IFC, ADB, AfDB, IBRD; and export credit and investment promotion agencies.
- ✓ **Monetary Grants**: Bounty, contribution, gift, or subsidy (in cash or kind) bestowed by a government or other organization (called the grantor) for specified purposes to an eligible recipient (called the grantee).
- ✓ **Venture Capital**: Startup or growth equity capital or loan capital provided by private investors (the venture capitalists) or specialized financial institutions (development finance houses or venture capital firms).
- ✓ Consider project financing – with or without recourse.

PPP Models

- Public Private Partnerships come in various forms and models – 'alphabet soup' of acronyms.
- The contracts may vary depending on the roles assigned to the parties, ownership structure, sector, risk allocation, investment responsibilities, operational requirements, structure and incentives for operators.
- Acronyms are normally used to underscore the particular ownership regimes and responsibilities of the private entity in these arrangements.
- Some of these models/acronyms include:

…..PPP Models

- Build-Operate-Own
- Build-Operate-Own-Transfer
- Build-Operate-Transfer
- Build-Rent-Operate-Transfer
- Service Contracts
- Operation or Management Contract
- Leases
- Franchise
- Asset Sale/privatisation

.....PPP Models

- **In addition, in terms of the 'alphabet soup' of acronyms**, there are also BLT (Build, Lease, Transfer),
- BLTM (Build, Lease, Transfer, Maintain),
- BOOR (Build, Own, Operate, Remove),
- LROT (Lease, Renovate, Operate, Transfer),
- DCMF (Design, Construct, Manage, Finance) and
- DBFOM (Design, Build, Finance, Operate, Manage).

Contractual Structure – Drafting of the Contracts

- A standard Public-Private Partnership project consists of an intricate web of contractual relationships linking the various parties involved in the project.
- The structure of the contractual relationship in such projects would depend on the model adopted, the sector and risks matrix.
- Thus, to ensure the success of a new infrastructure project it is imperative that the relationships and responsibilities of the parties are clearly defined at the initial stage of the transaction.
- The benefits and risks associated with the project must also be properly identified.
- Proper identification must be shadowed by an appropriate apportionment of these benefits and risks in the project documents. Essentially, the key players should analyse the risks, which may arise under the project, identify each contract to be put in place as well as the party to whom the risks are to be apportioned.

…….Basic Structure/Mechanics of a PPP

- Where it is the public sector that initiates the process, the public sector defines the services it requires over a long term period (typically 15-30 years) by reference to an output specification and closely specified performance criteria, without being too prescriptive about the means of delivery;
- No payments are made until the asset is delivered and working, and subsequently payments are subject to reduction if service performance standards are not met;
- Design risk, in terms of the decision on the type of assets needed to deliver the services to the required standard, is left to the private sector entity and the assets are effectively managed and operated by the private sector;

…….Basic Structure/Mechanics of a PPP

- The public sector provides no funding during the construction phase, and the risk of cost overruns, delays, etc rests with the private sector unless the public sector takes equity in the SPV (consider COVID-19);
- The public sector has to devolve control to the private sector over the assets and resources needed to deliver the service to such an extent that the private sector bears the risks and receives the rewards of effective ownership; and
- At the end of the concession period, the facility reverts to the public entity if there is no extension. (Note however that in models like Build, Operate, Own [BOO], there is no reversionary right.)

….. Drafting of the Contracts

- **The project documents would normally include the following**:
- ✓ The Project Agreement – the Concession Agreement – note the contents
- ✓ Construction Agreement
- ✓ Operation or Maintenance Agreement
- ✓ Direct Agreement or Substitution Agreement or Authority Step-in Clause in the Concession Agreement
- ✓ Funding Agreement
- ✓ Shareholders Agreement
- ✓ Insurance Agreement
- **The Project documents will depend on the type of model, sector, etc**
- **In a simple transaction, you may have one agreement – Concession Contract but note the Direct Agreement or Authority Step-in Clause**

Negotiating PPP Contracts

- Negotiation in Public-Private Partnership transactions is fundamentally about the allocation and assumption of risks and responsibilities
- Prior to the commencement of negotiations in a PPP transaction, the tender documentation especially the Request for Proposal (RFP), which should include the Draft Concession Agreement and other relevant documents, should be made available by the public authority for the interested bidding consortia to indicate interest.
- Ideally, the public authority should ensure that more issues are adequately dealt with in the tender documentation so that fewer items will be subject to the time consuming and costly negotiations after bids have been received

….Negotiating PPP Contracts

- On the part of the private sector, each interested bidding consortia (the private sector participants – the SPV) should have unity of purpose so as to avoid complicating negotiations and raising doubts as to the ability of the consortium to effectively work together as a team (eg Abuja Airport).
- A bidder that is able to effectively manage its internal negotiations and present a unified position is a much more attractive proposition to government than one that cannot
- Negotiations commence as soon as a bidder or concessionaire is selected by the procuring authority.
- In negotiating the Project Documents it is advisable for both sides to have negotiation teams made up of various experts.

….Negotiating PPP Contracts

- **Where the public authority does not have in-house expertise or competent staff to prepare the Project Documents or to carry out negotiations, it would have to look outwards and engage external advisers (eg P&ID Agreement)**.
- Negotiations in PPP transactions have to be carried out with extreme care and dexterity, particularly as it relates to allocation and assumption of risks and responsibilities.
- Thus the principles of risk allocation should always be borne in mind when negotiating these contracts – note principles.
- The concept of "risks" as it relates to infrastructure projects refers to those circumstances, which, in the assessment of the parties, may have a negative effect on the benefit they expect to achieve with the project.

….Negotiating PPP Contracts

- The parties would normally negotiate and agree who should bear the consequences of occurrence of events identified as project risks.
- This action is often referred to as risk allocation
- Some of the categories of risks which may be encountered by infrastructure projects include, *force majeure* i.e. happenings outside the control of the parties such as natural disasters; security and health challenges (bandits and COVID-19), disruptions caused by adverse acts of government (political risks eg Kaduna/Abuja Refineries); technical risks, construction risk, operating risk, revenue risk, financial risks, regulatory risks, environmental risks, change of law risks [stabilization clauses], foreign exchange risks, amongst others
- Generally, the cardinal principle is that risks should be allocated to the party that is best able to manage them

….Negotiating PPP Contracts

- A very effective way in which the PPP contract should allocate risks should be through output specification, which should specify the standard of service that is expected of the concessionaire for full payment to be remitted to him.
- Non- compliance with this service requirement will be to the detriment of the concessionaire, except where the failure to comply is a direct result of the authority's default on its obligation under the contract.
- Provide for conditions precedent, event of default, cure periods, termination, financial close, etc

….Negotiating PPP Contracts

- **Other mechanisms for allocating risks could be provisions in the contract pertaining to indemnities, warranties, risk mitigation instruments [PCG, PRG], payment methods and *force majeure*. For *force majeure*, however, there may be circumstances where risks will be shared.**
- Generally, when drafting and negotiating PPP contracts, it is imperative that the aforementioned points and issues are given due consideration.
- Not only for the major contract, but also for all the other contracts and sub-contracts which form part of the PPP transaction (the project documents).
- These points should also be borne in mind in PPP contract re-negotiations.

….Negotiating PPP Contracts

- Re-negotiation may arise from aggressive bidding, political and institutional issues, faculty contract design, faulty execution, faulty management, government's failure to honour its own obligations, micro-economic shocks, *force majeure* events, contract over-runs, banditry, health challenges eg COVID-19.
- Re-negotiation should therefore be carried out when justified

Concluding Remarks

- Public-Private Partnership transactions are no doubt, very complex arrangements that involve several parties, models and contracts.
- Therefore, a tremendous amount of time, expense and more importantly, expertise has to be invested in drafting and negotiating the Project Agreement and related documents, to ensure its success.
- There is the need to comply with constitutional, statutory, regulatory and other sectoral requirements.
- The choice of projects that will involve the private sector should be selective.
- Adequate and comprehensive feasibility studies (engineering, technical, environmental, financial, among others), must be carried out by the procuring authority or the project proponent in case of unsolicited proposals.

.....Concluding Remarks

- **It must be emphasised that were a project is economically weak and cannot provide acceptable rate of return to investors, public-private cooperation is unsuitable unless the public authority is ready to provide subsidies or guarantees or shadow tolling.**
- The nature of the partnership is also determined by the type of infrastructure – **hard economic infrastructure** (roads, motorways, bridges, ports, railways, airport, power, telecommunications) or **social economic infrastructure** (export assistance, technology transfer and vocation training). It can also be **hard social infrastructure** (hospitals, schools, water supply, housing, sewerage, prisons) or **soft social infrastructure** (social security, community services and environmental agencies).
- Thank you.

Any Questions?

THE END

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Reading List

a) Adedeji Adekunle & Paul Idornigie (Eds) *Public-Private Partnership in Infrastructure Delivery* (NIALS 2019)

b) UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects. 2020 (available at <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-10872_uncitral_ppp_e_ebook_2021.pdf> accessed 3 January, 2022)

c) UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects, 2004 (available at <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/03-90621_ebook.pdf> accessed 3 January, 2022)

d) OECD Recommendations on Public Governance of PPPs 2012 (available at <https://www.oecd.org/governance/budgeting/PPP-Recommendation.pdf> accessed 3 January, 2022)

e) Infrastructure Concession Regulatory Commission Act, 2005 (available at <https://www.icrc.gov.ng> accessed 3 January, 2022)

f) ICRC's National Policy on PPP, 2013 (available at <https://www.icrc.gov.ng/portfolio-item/national-policy-on-public-private-partnership/> accessed 3 January, 2022)