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TEMPLATE PROJECT AGREEMENT
USER GUIDE

National Development
Finance Agency

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INTRODUCTION

This guide has been produced for the purpose of providing guidance on the significant provisions of the Template PPP Project Agreement ("TPA"). It is not intended to be, and is not, a comprehensive summary of the TPA and does not in any way replace or amend the TPA. The Authority does not accept any liability or responsibility for any errors in, or omissions from this guide or for any reliance placed on it by users.

The TPA is a template Project Agreement which is suitable for PPP accommodation projects i.e. projects that involve the financing, design, construction, operation and maintenance of a building from which the private sector will provide the relevant service to the public sector.

Definitions used in this User Guide have the same meaning given to them in Clause 1 and Schedule 1 of the TPA.

The TPA has been drafted on the basis of the following assumptions:

1. There is a single building only. Adaptations will have to be made where there are multiple sites and buildings.

2. The Authority provides the site with outline planning permission but passes the ground condition risk to PPP Co.

3. Demand risk remains with the Authority.

4. Availability Risk is passed to the PPP Co.

5. There are no existing services on site to be taken over.

6. The project will be funded principally by way of Senior Debt with a small amount of equity/Junior Debt.

7. The risk profile of the Project is as per the Risk Matrix set out in Section 3 of this User Guide.

8. It assumes a typical consortium such as the following:

    - Project Company
    - Design and Build Contractor
    - Facilities Management Contractor
    - Equity providers
    - Senior Debt and Junior Debt providers

Whether or not there are separate Design and Build and Facilities Management Contractors and whether they take equity will depend on the nature of the Project Company.

If any of the assumptions above is incorrect, the TPA will have to be adapted.

CLAUSE BY CLAUSE COMMENTARY

Clause 1 - Definitions and Interpretation.

This will always be project specific and is integral to the TPA.

Clause 2 – Appointment

This is a standard clause that effects the legal appointment. It must be amended on a project specific basis to reflect what PPP Co. is doing.

Clause 3 – Term of Project Agreement

The TPA assumes a fixed term commencing on Service Commencement. Another way of dealing with this is to have a maximum length but have the Project Agreement terminate when a specified level of return has been achieved or some other agreed event has occurred. This is not common, but may be appropriate, for example, where a significant proportion of project revenues are generated from third parties by way of user charges and the Authority has a legitimate interest in capturing surplus revenues for the public benefit.

It is often possible for contract signature and financial close to be simultaneous. If there are project specific reasons for conditions precedent being required (e.g. planning conditions or permission), then the concept of conditions precedent and "Effective Date" may be needed (and the effect of pricing of interest rate fluctuations, between the date of contract signature and financial close, will need to be addressed).

Clause 4 – Delivery of Required Documents

The Required Documents set out in Schedule 11 are illustrative only and must be reviewed on a project specific basis.

Clause 5 – Representations, Warranties and Undertakings

Whilst some of the warranties, representations and undertakings are standard, this clause must be reviewed on a project specific basis.

The Authority should be very careful in warranting any information it provides. Warranties, to the extent given, should not extend beyond information on which PPP Co. must rely for its bid. Accordingly, the Authority should seek to minimise the extent of any warranties, unless:

- the Authority is the sole source of such information or such information cannot be verified by PPP Co. at reasonable cost;
- the Authority is confident in the accuracy of such information or is able to confirm its accuracy without significant expense (e.g. through surveys, in-house checks or inspections); and
- the Authority will obtain better value for money as a result (taking into account the overall risk allocation).

If the criteria listed above are satisfied and the Authority gives certain warranties, this will reduce PPP Co.'s costs. An example of where warranties are likely to be appropriate is where employees are being transferred by the Authority to PPP Co. or particular known risks exist in relation to a building (such as asbestos content).

Clause 6 – Land Issues and the Site

This must be looked at by a property lawyer on a project specific basis.

Clause 6.1 Licence

The usual position in an accommodation is that the public sector owns the site and licences it to PPP Co for the term of the Project Agreement.

Granting PPP Co a lease may give rise to problems under the ***Landlord and Tenant (Amendment) Act 1980*** (the "1980 Act") by which PPP Co may acquire statutory rights after five years' continuous occupation and be entitled to a renewal of a lease or to compensation in lieu of a new lease.

The 1980 Act does not apply in this way to a true licence although there remains the possibility that even if a licence is granted, the courts might construe the relationship between the local authority and PPP Co. as having the characteristics of a lease and may therefore grant a renewal of the terms of the "lease" to PPP Co at the end of the operation period. In other words, it is the existence of a particular relationship with certain characteristics that determines the existence of a lease as opposed to any formal grant of a lease or the designation of such relationship as a "license" or "lease".

Case law on the lease/licence distinction and the key elements that distinguish a lease is not entirely satisfactory.

> ***Irish Shell and B.P. Limited v John Costello*** [1981] ILRM 66 remains the leading Supreme Court case on the lease/licence distinction. Griffin J in the Supreme Court held the agreement to be a lease despite the fact that it was expressly described as a licence agreement. Griffin J stated that:-
>
> *"Whether the transaction is a licence or a tenancy does not depend on the label which is put on it. It depends on the nature of the transaction itself".*
>
> However, in subsequent dicta, Griffin J also placed importance on the intention of the parties, quoting from Lord Denning in ***Shell-Mex v Manchester Garages*** as follows:-
>
> *"One must look at the transaction as a whole and whether there are any indications that one finds in the terms of the contract between the two parties to find out whether in fact it is intended to create a relationship of landlord and tenant or that of licensor and licensee".*

Whilst the case law is not entirely satisfactory, it seems that, at least in the High Court, the intention of the parties may be taken into account. The best approach would therefore be to draft a licence omitting as many key elements of a lease as possible e.g. exclusive possession. There is obviously still a residual risk of a business tenancy being created in favour of PPP Co. However, in the absence of legislation this is considered the best option.

Clause 6.2 – Site Risk

Where the Authority provides the site on which the Project Facility is to built, it makes sense to obtain outline planning permission to ensure, in advance of the tender process commencing, that the Project is feasible. The Preferred Bidder will then be responsible for obtaining full planning permission on the basis of his detailed design.

However, the Authority normally passes the risk associated with the condition of the site (being the risk that adverse ground conditions could cause increases in cost and/or construction delays) to PPP Co. This position is reflected in the TPA. PPP Co. will in turn pass the risk to D&C Co. D&C Co. will mitigate its loss by way of due diligence on the site and site surveys to ensure an appropriate construction bid is compiled. If the information turns out to be wrong, then the risk of increased costs or delays lies with D&C Co., who would also indemnify PPP Co. against any impact of delay.

Clause 6.3 - Archaeology

Archaeological risk is a particularly sensitive issue in Irish projects. Depending on the nature of the site and project, it may be appropriate to include this in the list of Relief Events. Alternatively, a risk sharing approach to cost could be used.

The TPA includes Archaeological Discoveries in the list of Relief Events and offers a cost sharing option. However, the public sector should always consider on a case-by-case basis, whether it would be better value for money to bear this risk itself.

Part 5 – Design and Construction

This whole section must be reviewed on a Project specific basis.

Clause 7 – The Works

Once the Project Agreement is signed and in force, PPP Co. carries out its construction or development obligations and puts in place the service procedures which it believes will meet the Output Specification.

During this period, the Authority wants to know whether PPP Co. is going to deliver the Service on time and in a way that meets all the Authority's contracted requirements. PPP Co. will not wish to be unnecessarily hampered by the Authority and will also want reassurance that what it is developing will meet the Authority's requirements.

The issue here is the extent of Authority involvement during this phase and what rights, if any, the Authority should have to approve or monitor PPP Co.'s progress before Service Commencement Date.

There must be a clear limit to the extent of the Authority's participation, as involvement to a greater extent than is appropriate may lead to the Authority taking back both a risk which it is paying PPP Co. to accept and a management role it is paying PPP Co. to deliver.

It is not normally appropriate for the Authority to adopt the type of overseeing role it might traditionally expect to have when procuring stand-alone construction or development services.

PPP Co will be responsible for the design, construction, integration, installation, testing, commissioning, operation, maintenance and ultimate performance of any asset procured or developed for the purposes of meeting the requirements of the Output Specification. The Authority should not (save in exceptional circumstances) take any responsibility for these risks. Correspondingly, PPP Co. should be afforded the freedom to manage its activities without interference from the Authority.

It is PPP Co.'s risk whether the design and development it has carried out and the operational procedures it has put in place are capable of satisfying the Authority's service requirements.

The Authority should not, save in exceptional circumstances (for example, those giving rise to Authority step-in), agree to any role before or following Service Commencement which involves the Authority taking back any part of PPP Co.'s risk. In this context, the Authority should not make payments against construction milestones nor should it have a right of termination for failure by D&C Co. to meet a construction milestone.

The Authority should not confirm to PPP Co. that proposals will meet the service requirement. In practice, however, the Authority should be confident before signing the Project Agreement that PPP Co.'s proposals will be capable of delivering the Service once fully developed and implemented. The Authority should also ensure that PPP Co.'s basic design proposal is incorporated into the Project Agreement.

The Authority's role after signature of the Project Agreement and before Service Commencement will normally include:

- reviewing and commenting upon PPP Co.'s designs, maintenance and operational procedures as they are developed;
- viewing and observing tests of any equipment being developed;
- administering the agreed process for either PPP Co. or itself to propose and implement changes to the output requirements, constraints on inputs or PPP Co.'s proposals;
- following the agreed procedure by which PPP Co. demonstrates to the Authority that Service Commencement can be accepted;
- following the agreed procedure in relation to a failure to meet the Service Commencement Date and agreeing with PPP Co. the measures to be taken and the financial consequences; and

- auditing PPP Co.'s activities in accordance with an acceptable Quality Management Systems regime.

The Authority should require only as much management information as is necessary to be reassured that the delivery timetable is on track and any overriding safety issues are being satisfactorily addressed. This will involve having access to the site.

The Authority should not, for example, retain any rights to approve or accept interim stages such as practical completion of construction or detailed design before acceptance of Service Commencement, as this may dilute any risk transfer (unless, of course, the Authority takes the risk of commissioning as the UK NHS does for clinical services in relation to the technical interface in hospital projects).

Clause 8 - Design Review Procedure

Although PPP Co. is responsible for the design development, the Authority knows its own service requirement and the means by which it has been delivered in the past. This should not be lost to the development process.

Consultation with the Authority and subsequent adoption of any comment made by the Authority must, however, remain firmly at PPP Co.'s risk. PPP Co. and its Funders should accept that it is not in the Authority's interests to watch without comment as a design is developed and implemented which it knows will not be able to deliver the Service. The procedure for submitting and commenting on design issues should be capable of giving all parties the reassurance they need.

The Project Agreement should therefore set out a mechanism for:

- PPP Co. to submit designs and information to the Authority and its representatives. Such designs should be in a package and format and submitted to a timetable to be agreed between the Parties;

- PPP Co. to submit minor design changes which do not have any impact on cost or the Service and which the Authority can accept without the change in Service mechanism having to be implemented;

- the Authority to comment (if it wishes) on such submissions within an agreed time period; and

- the discussion of and, if appropriate, adoption by PPP Co. of any comments by the Authority.

Clause 9 – Quality Assurance

This is relatively straightforward and should not have to be amended.

Clause 10 – Construction Programme

PPP Co. must comply with the agreed Construction Programme. However, PPP Co often wants to incentivise D & C Co by paying a "bonus payment" for early completion. The Authority should only agree to this at Project Agreement level if it is to its advantage. The term "bonus payment" can be misleading, however, so it is important to understand what is envisaged and how it ties in with the implications of early Service Commencement.

The key point for the Authority is that it should not be under an obligation to accept early Service Commencement (unless it has otherwise agreed). It should only accept early Service Commencement and payment of any relevant bonus if it offers value for money.

Early Service Commencement may prove good value for money if there is a critical demand for the Service or if it would benefit the Authority financially. This might be the case, for example, if the early start date meant the Project generated additional third party revenue, or PPP Co. made savings, in which the Authority shared. Any benefit to the Authority should be assessed on a case by case basis.

There is unlikely to be an advantage to early Service Commencement of more than a few weeks in the case of a school that is working to term times.

There may be budgetary problems for some Authorities (such as local authorities) in accepting and paying for early Service Commencement. These are likely to be surmountable if sufficient warning is given by PPP Co. of early commencement, particularly as the Authority would in many cases be sharing in extra revenue or savings.

If the Authority decides to accept early Service Commencement, PPP Co.'s revenue stream will commence earlier than originally planned. The Authority will have the choice between bringing the Expiry Date forward to retain the length of the original Service Period or retaining the original Expiry Date, thereby extending the original Service Period. This is where the "bonus" payment concept is relevant since:

1. if the Authority retains the original Expiry Date, PPP Co. will receive a "bonus" amount of revenue through the Unitary Charge payable in respect of the longer Service Period.

2. if the Authority brings the Expiry Date forward, the Authority may either simply pay the Unitary Charge for the same length of Service Period (i.e. essentially what it would have paid originally), which involves a "bonus" element (as payment is being received earlier) or it may pay PPP Co. a "bonus payment" equivalent to the additional amount PPP Co. would have received if the original Expiry Date had instead been retained. The difference between this approach and the alternative outlined above is that this bonus would not be subject to deductions as a result of unavailability or poor performance. It would also be likely to be paid as a lump sum;

The Authority may alternatively simply opt to make a "bonus payment" which is unrelated to the length of the Service Period or any additional amounts of revenue which PPP Co. may expect to receive due to its early Service Commencement. Such a bonus would typically be an agreed fixed amount.

The TPA permits early completion within a defined timeframe but this is very project specific and is offered only as one possibility.

The TPA does not impose liquidated (i.e. pre-quantified) damages for late completion. Provisions of that nature should only be inserted if there are project specific reasons for requiring them and the Authority can demonstrate that PPP Co. pricing this risk represents value for money.

Liability for general damages for late completion has been excluded on the same basis.

Clause 11 – Independent Tester

The TPA follows a process whereby an Independent Tester certifies practical completion. This may or may not be suitable and the role of the Independent Tester must be considered on a project specific basis.

Clause 12 – Commissioning and Completion

Before Service Commencement and at points during the Project where the service changes significantly (for example on the introduction of a new asset or new operational procedures), PPP Co. should be under an obligation to demonstrate that the arrangements put in place will meet the Output Specification in the Project Agreement. The method of demonstration by PPP Co. will be dependent on each situation but may take the form of:

1. a completion inspection of any asset built or developed with demonstration of principal facilities and services;

2. completion of acceptance trials for new services; and

3. other performance tests or inspections.

The Project Agreement should set out in detail:

1. the form of the tests, inspections or demonstrations ("Tests") to be carried out by PPP Co.;

2. the timetable for the Tests – it may be appropriate to undertake partial Tests over a period rather than a single Test;

3. the consequences of a failure to pass a Test;

4. the notice procedure for the Tests to be followed by PPP Co. – this is particularly important if the Authority has to roster staff and resources to participate. If it is essential for the Authority to attend the Tests, then PPP Co. should specify a time period for the Authority to respond to the notice and, to the extent that the Authority does not respond in time, a Compensation Event will have occurred (see Clause 41 (Compensation Events)) although the Authority can still attend once it has responded. The TPA provides that attendance by the Authority is not essential;

5. the responsibility for the cost and organisation of resources for the Tests. Again this is particularly important if the Authority's staff and resources are to

be involved (also consider the responsibility for costs if Tests have to be repeated);

6. means of access for the Authority to witness the Tests (if the Authority does not control the site);

7. the documentation required by the Authority as evidence of the results of the Tests;

8. who is responsible for assessing satisfaction of the Tests; and

9. the timing and procedure for acceptance of Service Commencement if the results of the Tests are satisfactory.

The Authority should not accept stages of work (e.g. by signing off milestones) before the Service Commencement Date and delivery of the full Service as this dilutes risk transfer. In certain projects, however, it may be appropriate for the Authority to commence payment before a complete service is available. The principal examples of these are as follows:

- in roads projects, where a permit is issued allowing traffic to use the road once certain safety standards have been achieved, although construction may not be fully completed. Final acceptance of the road takes place once PPP Co. has completed the outstanding construction works and the payment mechanism is structured to ensure that PPP Co. is incentivised to do so;

- in accommodation projects, the Authority may accept Service Commencement where certain minor aspects of the construction works are incomplete but which are not integral to PPP Co.'s ability to provide the main Service – this may be done by specifying particular areas (e.g. landscaping works) or through more generic descriptions (e.g. "de minimis defects, shrinkages or faults"). Whether it is agreed before or after signature of the Project Agreement, the Authority must ensure that PPP Co. remains incentivised through the payment mechanism to complete the outstanding works. The Authority's technical adviser should advise on what aspects of the works can be completed after Service Commencement.

- in projects in which Service Commencement is phased (i.e. different buildings or pieces of equipment are brought into service at different times), then an appropriate phasing in the introduction of payments (again with built-in incentives) may be appropriate.

In projects where Service Commencement is phased, there are two clear alternatives available to the Authority:

- to stipulate that full Service Commencement will only be accepted when all phases in the scheme reach the required Output Specification level, which would incentivise PPP Co. to bring them all up to the Output Specification standard as quickly as possible. This would mean, however, that the Authority would receive the full Output Specification level of service for some phases without paying for it; or

- to accept full Service Commencement as each phase reaches the Output Specification standard, so that payments reflect the service received. A slight variant to this that may be adopted in very large grouped schemes, where it would be administratively cumbersome to have phase by phase Service Commencement, would be to accept Service Commencement in batches as full service availability is confirmed. If this approach is adopted, some of the incentive effect of the first alternative above can still be achieved if payment is not increased pro rata as phases reach the Output Specification, so that there is in effect an amount retained or abated until the last phase reaches Service Commencement.

The overall time period until the planned completion and service commencement of the last phase is likely to have a significant impact on the relative value for money of these two alternatives – the longer the period, the more reluctant PPP Co. is likely to be to accept the delayed payment involved in the first alternative above.

For example, an educational establishment may want to start using the new facilities outside full term times, and preferably in the long summer break. The Authority should make clear its requirements in this respect in the Invitation to Negotiate

Existing Services

The approval/acceptance procedure raises other issues if PPP Co. is taking over existing services as well as undertaking additional services. The Authority should structure the payment mechanism and any termination compensation so as to incentivise PPP Co. to start delivery of the new service on time, so that it cannot simply choose to provide the existing service only. This is the case even where provision of the existing service is more important to the Authority from an operational perspective than provision of the new service.

The first question to address is, when does PPP Co. take over full or partial responsibility for service delivery? Authorities should recognise that any TUPE transfers of staff that may arise are likely to take effect from the time at which PPP Co. takes over provision of the relevant service. There are therefore three options open to the Authority:

(i) hand over responsibility for all sites in the Project Agreement to PPP Co. following financial close, commonly after a brief mobilisation period. This provides a clean start and minimises ambiguity about responsibilities of the Authority and PPP Co., and is therefore the recommended approach. However, in some cases, for example where there are particular concerns or uncertainty about the condition of the buildings, this approach may require PPP Co. to take on risks that are unacceptable to it at a realistic price, and so not provide value for money;

(ii) phase the handover so that PPP Co. takes over responsibility for the sites when it has planned to start works on them to bring them up to the full Output Specification standard. This would leave the Authority responsible for some sites between financial close and the programmed start date of PPP Co.'s work on site. For a large grouped scheme this may well complicate management arrangements throughout the transitional phase from financial close to the point at which all of the sites have reached full Service Commencement, but is recommended where the first approach above does not provide value for money; and

(iii) hand over the sites to PPP Co. once they have been brought up to the full Output Specification standard. This would cause an additional complexity as the pre-contract arrangements, involving in-house provision or a separate contractor, would continue in relation to facilities management (if relevant) and operation of the accommodation, whilst PPP Co. was carrying out works to bring the sites up to the Output Specification standard. The possibility of disputes about who is responsible for problems that arise suggest that this would not be an attractive option, and it is therefore not recommended.

In some cases, the existing conditions of buildings may be such that there is a risk (however remote) of criminal prosecution, for example under Health and Safety legislation. The Output Specification will generally require the buildings to be in a condition that complies with all applicable law. In some schemes prospective shareholders of PPP Co. will be understandably nervous about taking on such a risk for the period before Service Commencement. In such circumstances, Authorities should consider retaining legal responsibility for the buildings until planned Service Commencement, and so any existing services provided by PPP Co. may be dealt with in a maintenance and/or O&M Contract.

In relation to the first two options, a specification will be needed for the service level that is expected for the period while PPP Co. is responsible for each site, but has not yet reached full Service Commencement. Such specification should include requirements in relation to individual O&M Services that PPP Co. will be required to provide (if relevant), and a reactive and responsive maintenance and repair service that at least keeps the sites open to the standard they are when the Project Agreement starts. It is important for all parties that there is a common understanding of the service required during this period. This will assist in minimising disputes if under-performance occurs. There are generally two options available to the Authority:

- use the Output Specification that will apply from Service Commencement for the transitional period as well, albeit with a relaxed payment and performance regime (including default termination thresholds). However, this may lead to regular performance failures due to the pre-existing condition of the buildings and cause disputes between the parties; or

- tailor a bespoke specification for the transitional period which sets out the Authority's requirements and is realistic in terms of delivery. In relation to some individual service requirements however, the Project Agreement Output Specification may be relevant and sufficient for the transitional period (e.g. response and rectification periods, or if it is reasonable to expect individual "soft" O&M Services to be provided to the Output Specification standard from the award of the Project Agreement). However, where the Output Specification for the Service Period cannot be met by PPP Co. during the transitional period, bespoke outputs will need to be tailored.

Clause 13 – Health and Safety

This is relatively straight forward and should not have to be amended.

Clause 14 - Building Contract and Professional team

This is relatively straight forward and should not have to be amended.

Clause 15 – Necessary Consents

The TPA provides that PPP Co must obtain all necessary consents (other than planning). However, this must be considered on a project specific basis.

Clause 16 – Equipment

The area of Equipment is very project specific.

Some projects, such as schools, will have large amounts of furniture, sports equipment and possible lab equipment but nothing very high-tech or sensitive. In such circumstances, it is probably good value for the Authority to transfer risk entirely to PPP Co. as PPP Co. can make a good estimate of the life of a piece of furniture and will factor replacement at a given time into the Project Costs. There is very little risk premium involved.

An oncology unit on the other hand will involve large pieces of extremely costly medical equipment and issues of installation, maintenance, technology refresh, etc are paramount to obtaining value for money.

While the current drafting in the TPA might be suitable for a school or an office building where PPP Co. provides much of the furniture and equipment with some coming from the Authority's existing stores, it would not be suitable where very high-tech and expensive equipment is involved.

The issue of IT must be considered on a project specific basis.

Part 6 – Operation and Maintenance

Clause 17 – Services

This provides that the Services must be provided in accordance with a list of documents in order of priority but starting with the O & M Specification. This is the benchmark against which the Service Performance will be judged and it is therefore essential that this document is sufficiently clear and developed before the Project goes to the market.

Clause 18 – Maintenance of the Project Facility

This must be considered on a project specific basis.

PPP Co. will base its costings on a forecast capital replacement programme of plant, machinery, equipment, fixtures, fittings and furniture designed to maintain the building environment at the specified output standards. PPP Co. will also consider the means of funding this expenditure throughout the life of the Project. The risk associated with assessing what will need replacing, when and how much this will cost, is one that PPP Co. should take and therefore the Authority should not attempt to be prescriptive in this respect.

The Authority will find it easier to achieve this risk transfer if it starts by expressing its service requirements as an Output Specification. Bidders should be allowed to develop their own proposals which may, for example, incorporate alternative programmes of maintenance where assets with longer life are used or used differently. An Authority should not attempt to impose its own system of asset replacement on bidders.

PPP Co. should, however, prepare a planned preventative maintenance programme so that both parties know when parts of the Service are permitted to be "unavailable" without any payment deductions being made. The Project Agreement should also contain a mechanism by which either party can propose reasonable alterations to the planned programme (i.e. alterations which will not adversely affect the delivery of the Service).

The Unitary Charge will usually be made on a broadly level basis in accordance with the Authority's budget, whereas the need for capital replacement will only occur at intervals (although exceptional payments may be sculpted to give a non level profile to the Unitary Charge). The Unitary Charge will accordingly include amounts to cover PPP Co.'s anticipated future expenditure on maintenance, such as servicing plant and other more major refit maintenance.

PPP Co. will therefore usually build up a sinking fund over some years, in anticipation of significant capital expenditure in future periods. It will usually be required to do so by its funders, particularly where the maintenance risk is left with PPP Co. and not passed to Sub-Contractors. The sums involved could be considerable.

Maintenance should be left firmly at PPP Co.'s risk and the Authority should not attempt to prescribe the quantum, location or availability of a sinking fund. The Authority should consider whether it needs to take security over the sinking fund or whether it is adequately protected by the Project Agreement. For example, if the term of the Senior Debt is significantly shorter than the Term of the project Agreement, the Authority may wish to have secured rights over a sinking fund once the Senior Debt has been repaid in full.

If the size of the Project (including associated maintenance obligations) is comparatively large in relation to the financial resources of a PPP Co. which is not relying on third party Senior Debt financing, the Authority may want to consider requiring a sinking fund over which it has secured rights.

The Authority will wish to ensure that PPP Co. is as equally incentivised to maintain the Assets in the latter years of the Term as it is in the early years. The Authority should have the ability to conduct a final survey towards the end of the Term and withhold payment of the Unitary Charge if the Assets are not restored to the required maintenance standard.

To protect themselves in the event of PPP Co. Default, the Senior Lenders will have a charge over the sinking fund as security. PPP Co. should look to its own resources first to repay its Senior Lenders, and so any compensation payable to PPP Co. by the Authority on a termination should be reduced by all cash held by PPP Co., including amounts in sinking funds.

Clause 19 – Authority Step-In

In some circumstances, the Authority may wish to take action itself in relation to the Services if there is a need to prevent or mitigate a serious risk to health, safety (person or property) or the environment or to discharge a statutory duty. Such a right may arise due to matters outside the scope of the work of PPP Co. or may arise due to PPP Co. being in breach of obligations under the Project Agreement.

Such a right of the Authority is often referred to as "step-in" (and this is the terminology used here for that reason), as it involves the Authority taking over some or all of the obligations of PPP Co. for a period. It should, however, be viewed as being entirely different in nature and purpose from a step-in by Senior Lenders under a Funder direct agreement and separate from the PPP Co. Default provisions. Essentially, the focus of the right is a serious short term problem that can or must be solved quickly, where the Authority is in a better position to do this than PPP Co. The Authority should not in any situation be obliged to step-in.

If there has been no breach by PPP Co. in the circumstances set out above the Authority should notify PPP Co. that it plans to step-in and the extent of such step-in. To the extent the Authority steps in, it will be effectively removing any obligations affected by such step-in from PPP Co. and performing them itself.

During its step-in, if the Authority needs to act for reasons external to PPP Co., the Authority should pay for the Service as if the Service had been fully performed, subject only to any deductions to be made in respect of parts of the Service still provided by PPP Co. (e.g. to reflect performance on that part) and unaffected by the Authority's step-in. Payment should be conditional upon PPP Co. agreeing to provide reasonable assistance to the Authority at this time.

The Authority should bear all its own costs incurred by stepping-in in this circumstance.

If a PPP Co. breach gives rise to a need for the Authority to step-in in the circumstances set out above and PPP Co. has failed to remedy the breach within the agreed time period, the Authority should have the right to step-in and carry out such rectification itself (for example, using a third party) at PPP Co.'s expense.

Where the Authority steps-in upon PPP Co.'s breach, the Authority should continue to pay PPP Co. as where there is no breach. The Authority should, however, be entitled to set off any costs it incurs in stepping-in in such circumstances (i.e. for both costs of work and advice and for time devoted to running the operations) against the Unitary Charge payable to PPP Co.

Part 7 – Relationships and Monitoring

Clause 20 - Reports

Clause 21 - Records

Clause 22 - Liaison Procedure

Clause 23 - Representatives

These clauses set in place the procedures and relationships necessary to make such a long-term and complex contract work in practice. This is relatively straightforward but should be considered in the context of the project. For example, each project will require specific types of periodic reports.

Part 8 – Payment and Market Testing

Clause 24 – Payment

This must be reviewed on a project specific basis.

Clause 25 – Market Testing and Benchmarking

Generally, only soft services are appropriate for either benchmarking or market testing.

"Soft Services" means services such as facilities management services in an accommodation project (typically those such as catering, cleaning and security) to the extent they do not involve a significant capital outlay in their performance or affect the value of any capital asset under the Project Agreement. This definition is used because the prices charged must be comparable with those of a potential alternative Sub-contractor and, to the extent capital costs have been incurred by a Sub-contractor it is not realistic to expect a price including those capital costs to be competitive with a bidder whose costs do not include those costs. Services such as building "re-fit" or life-cycle maintenance should not be benchmarked or market tested.

Benchmarking

The term "benchmarking" is used to mean the process by which PPP Co. compares either its own costs or the cost of its Sub-contractors providing soft services against the market cost of such services. If the relevant costs are higher than market costs, a reduction in the price charged to the Authority should be made on an agreed cost-sharing basis to reflect the differential. If costs are lower than market costs, any price increase must be justified by PPP Co. For example, an increase may be required to restore PPP Co.'s base case return.

The Authority should specify in the Invitation to Negotiate when the first benchmarking exercise will take place. There should usually be a longer initial period (well into the Service Period) before such provisions are implemented, to ensure that bidders do not set a deliberately low initial price which they then try to increase through the review. An excessively long initial period may, however, expose the Authority to an unreasonable price premium for transferring this risk for a longer term. Alternatively, the first benchmarking exercise should be capable of resulting in decrease in price only or a capped increase in price.

Market Testing

In this guidance, "market testing" means the re-tendering on the market by PPP Co. of the relevant Sub-contractor's soft service to test the value for money of that service. Any increase or decrease in the cost of such service as a result of market testing requirements in the Project Agreement which result in the replacement of a Sub-contractor should be reflected by an adjustment in the price charged to the Authority.

This should generally only be undertaken where the parties have failed to agree on the results of a benchmarking exercise and there is a real prospect of competition. Market testing is likely to be more disruptive to PPP Co. (and, therefore, possibly the Authority) than benchmarking as it may require replacement of a Sub-contractor.

Part 9 – Taxes

Clause 26 – Taxes

Clause 27 – Value Added Tax

Clause 28 – Rates

The taxation and rating of PPP Projects has been the subject of separate Guidance which should be consulted in respect of each Project. The drafting in the TPA must be looked at on a project specific basis.

Part 10 – Change

Clause 29 – Variation Procedure

This sets out the procedure to be followed if either Party wants to change the terms of the deal during the life of the Project. The basic rule is that where the Authority wants to introduce a Variation, PPP Co must implement such change except in certain specified circumstances. The Authority must bear the cost of any such Authority Change.

Clause 30 – Change in Law

Under more traditional commercial contracts, PPP Co. is usually able to pass on the costs of changes in law 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 changes in law arising during the term of the contract. As the prices in PPP contracts are agreed on a long-term basis and are not flexible in the same way, PPP Co. will often not be in a position to price the full cost of changes in law effectively.

A sharing approach is the best way to ensure that the costs of implementing changes in law are minimised. The approach set out in the TPA in respect of the sharing of risks relating to changes in law is intended to play to the strengths of both the public and private sectors and ensure that PPP Co. is incentivised to manage its costs, even where the Authority agrees to meet PPP Co.'s costs resulting from complying with a change in law. It should not be changed unless there is a project specific reason to do so.

Part 11 – Employment Issues

Clause 31 – Transferring Employees

The *European Communities (Protection of Employees rights on Transfer of Undertakings) Regulations 2003 (SI No. 131 of 2003)* safeguards the rights of workers on a transfer of the employing undertaking by ensuring that workers are entitled to continue working for the transferee employer on the same terms and conditions as those agreed with the transferor employer. Whenever a transfer is within the Directive, contracts of employment run with the undertaking; the transferee cannot take the business without the employees and must take those employees subject to existing employment rights and obligations. Further, a transfer cannot constitute grounds for dismissal, whether carried out by the transferor or transferee, unless there is an economic, technical or organisational reason entailing changes in the workforce.

This can be a very sensitive part of any Project and must be looked at on a project specific basis.

Clause 32 – Staff During Operation

This applies to all staff of PPP Co. whether or not they have transferred. This must be looked at on a project specific basis.

Part 12 – Termination

Clause 33 – Termination for PPP Co Default

The Project Agreement must deal comprehensively with the possibility of early termination due to PPP Co. Default. It must achieve a fair balance between the Authority's desire to be able to terminate for inadequate service provision, even if caused by relatively minor defaults (a right which Authorities are used to having in conventional service contracts) and PPP Co.'s and its Funder' interest in restricting termination to the severest of defaults, when all other reasonable alternative options have been exhausted, including a reasonable rectification period procedure and a direct agreement. It should be the Authority's last resort to exercise rights of termination.

The Project Agreement should specify the events of PPP Co. Default which may lead to termination. As far as practicable, these should be objective, clear and provide for reasonable tolerances, bearing in mind the undesirable consequences of termination.

Termination for Persistent Breach by PPP Co.

The Project Agreement should incentivise PPP Co. in some way in respect of any breach by PPP Co., however minor. There are various means to deal with the persistent occurrence of minor defaults. A common approach is to impose performance points in respect of all types of minor defaults. This is a particularly effective means of incentivising PPP Co. when coupled with a right to terminate the Project Agreement if the total number of performance points accrued exceeds a certain level.

It may not be feasible in every case to negotiate an all-encompassing performance points regime. This could leave the Authority exposed to a situation in which minor breaches are occurring persistently or being left unremedied, but as they have no effect on the Unitary Charge, the Authority will have little ability to influence PPP Co. to perform. It may in fact be cheaper for PPP Co. not to perform and suffer the (inaccurately calibrated) deductions. If such circumstances are likely to exist, the Authority should retain a right to terminate the Project Agreement for Persistent Breach rather than trigger termination following accrual of a certain number of performance points. PPP Co. and its Funders will be anxious to avoid a "hair trigger" default and will wish to ensure the mechanics relating to this default are as objective as possible. As payment and performance mechanisms develop and are seen to work well in established sectors, there will be less of a need for such a provision.

The Project Agreement should therefore include a warning procedure which provides that PPP Co. is served a formal preliminary notice that a certain type of breach has been persistently occurring during the Service Period. If such breach continues to occur persistently following such notice (allowing a short rectification period), a final notice is served warning that any further single occurrence of such breach will entitle the Authority to terminate the contract. This then gives PPP Co. the opportunity to remedy.

Rectification

The Authority should afford PPP Co. the opportunity of remedying any breach capable of remedy and/or financially compensating the Authority for the effects of the breach. Termination should only be used as a last resort. Accordingly, the Project Agreement should set out a mechanism allowing PPP Co. the opportunity to remedy breaches which are capable of remedy to avoid termination. Rectification will not be appropriate in respect of all types of breach. Some breaches may not be capable of remedy (for example, failure to complete construction by the Long-Stop date) and some events may only qualify as termination events after some kind of grace has already been given (e.g. after the accrual of a specified level of Performance Deductions or because of the tolerances contained in the Persistent Breach concept).

Clause 34 – Termination for Authority Default

PPP Co. should be allowed the right to terminate the Project Agreement where the Authority acts in a way which renders their contractual relationship untenable or completely frustrates PPP Co.'s ability to deliver the Service. A minor breach will not fall into this category and even a material breach of itself is likely to be insufficient if the Authority's actions do not have the effect described above.

Other than the circumstances listed in the TPA, the circumstances in which PPP Co. is permitted to terminate for Authority Default must be considered on a project by project basis. The Authority needs to examine the nature of its obligations during the Project and should only extend the list of Authority Default events to include breaches of other obligations which will render the contractual relationship untenable or completely frustrate PPP Co.'s ability to deliver the Service.

Termination by PPP Co. should be a last resort and it is important to ensure that there are no "hair triggers" which could put the Authority at risk of termination before it has had an opportunity to remedy its default. There can be no question of reciprocity with the defaults that trigger a PPP Co. Default as the obligations of the Authority are principally payment obligations and approval rights, rather than detailed performance or other credit related obligations.

PPP Co. should bear in mind that a failure by the Authority to comply with the provisions of the Project Agreement before the Service Commencement Date (for example issuing approvals) and sometimes after that date, can in most cases be adequately dealt with by way of a Compensation Event. In addition, any failure by the Authority to pay sums when due should give rise to interest on late payment and so a reasonable grace period for non-payment should be built into the Project Agreement and so neither of these should trigger termination.

Clause 35 – Voluntary Termination

The intention of all parties to a Project Agreement should be that it will run its full course. There may be circumstances, however, in which the Authority is no longer able to continue the relationship it has with PPP Co. under a Project Agreement. For example, there may be a policy change which makes further provision of the Service redundant. In order to cater for such circumstances, the Authority may wish to retain the right to terminate the contract voluntarily.

PPP Co. should not object to the Authority having such a right provided that it is compensated in full if such right is exercised.

PPP Co. should receive a termination payment which leaves it in the position it would have been in had the Project Agreement run its full course.

Clause 36 – Termination for Force Majeure, Change in Law and Uninsurable Risks

The Project Agreement should define the Force Majeure Events that can lead to termination and determine the rights of the relevant Parties if this occurs. If a Force Majeure Event occurs and the parties cannot agree a solution within a specified period (six (6) months is typical), either party is entitled to terminate the Project Agreement with compensation payable to PPP Co. as set out in Part 3 of Schedule 17 (Compensation on Termination). The Project Agreement should, however, give the Authority the right to prevent Termination by paying the PPP Co. as if the Service were being fully provided after such period. In such circumstances the Authority should specify a fixed period for which it will make such payment, before reconsidering the situation, so that PPP Co. can plan accordingly

Clause 37 – Termination for Breach of the Refinancing Provisions

The Project Agreement must deal comprehensively with termination as a result of a breach of the refinancing provisions by PPP Co.

A balance must be struck between the Authority's proper desire to incentivise PPP Co. to be open and transparent in relation to refinancing, and the Senior Lenders' fear of losing their funding for reasons beyond their control due to the actions of PPP Co.

Clause 38 – Termination for Corrupt Gifts and Fraud

The Project Agreement must deal comprehensively with termination as a result of corrupt acts or fraud involving PPP Co., any Sub-contractor and any servant or agent of the Authority.

A balance must be struck between the Authority's proper desire for the right to free itself from a corrupt or fraudulent partner and the funders' fear of losing their funding for reasons beyond their control due to the corrupt actions of PPP Co. or third parties or an individual within either of them.

The corrupt gifts and fraud provision is aimed at all types of bribery, corruption and fraudulent acts perpetrated against the Authority, in connection with the procurement of the Project Agreement and the ongoing contractual relationship.

As the Authority's ultimate sanction to terminate for such acts is severe, the recommended approach allows PPP Co. the opportunity to avoid termination where the act has been carried out by a Sub-contractor or employee acting on his own. Within a specified reasonable time period, PPP Co. has to ensure that any relationship with the relevant Party is terminated and, if applicable, a replacement procured for such party.

Clause 39 and Schedule 17 – Compensation on Termination

This is a critical part of the project. The Compensation on Termination in the TPA should not be amended unless there are project specific reasons to do so.

Schedule 17 Part 1 - Compensation on Termination for PPP Co. Default

The amount of compensation payable on PPP Co. Default termination is one of the key commercial issues for all parties concerned. The Market Value approach described below is the recommended approach for all accommodation projects.

The market value approach represents a balance between protecting the Authority's interest and not imposing unreasonable deductions on PPP Co. for its default. It also encourages the Senior Lenders to step in and rescue the Project instead of simply relying on the termination payment to pay their outstanding debt.

The "no compensation" models have been driven by a proper concern that, on PPP Co. Default, Senior Lenders should be encouraged to step in and work the Project out. They do however, expose the public sector to the charge that it is seeking a possible windfall gain in the event that termination occurs (e.g.. if it takes over a valuable asset), although this may be refuted by the Authority agreeing to pay the market value for any assets to be transferred to it. They may also serve to increase the costs of projects to the public sector by forcing bidders to take a conservative approach to risk pricing, liquidated damages and the limits on liability they require from the sub-contractors.

On the other hand, calculations based on the NPV of future cashflows have proven to be extremely complex and difficult to negotiate. In practice, they are unlikely to take full account either of the performance history of the defaulting Project (and so expectation of future performance), the extra costs accruing to the Authority over the Term or of the risk transfer to PPP Co. (particularly in relation to whole life costing). Equally, if payments based on NPV calculations were sufficient to pay Senior Debt in full, the Senior Lenders would have less incentive to rescue the ailing Project. This might well result in terminations which would otherwise have been avoidable and would be to the detriment of Authorities and PPP Cos.

The Market Value approach facilitates the Senior Lenders right to step-in, manage and rescue or sell the Project if PPP Co. defaults, but, if they fail to do so, offer compensation on termination based on the market value of the unexpired Term.

The recommended approach:

- does not require the Senior Lenders to make attempts to take responsibility and seek to transfer the Project if there is no liquid market for similar PPP projects;
- does not penalise Senior Lenders for stepping in if, subsequently they choose to step-out
- increases the incentives for Senior Lenders to work with the Authority and PPP Co. to achieve a long term solution rather than terminate a project that hits difficulties;
- ensures that the Authority is no worse off as a result of the termination where Senior Lenders elect not to step-in;
- does not give the Authority a windfall gain on termination; and
- does not discriminate against different classes of finance or against bidders who are prepared to finance the Project through their own balance sheets.

If the Authority issues a Termination Notice to PPP Co, the Senior Lenders will require an opportunity to put together a remedial plan and accordingly, the right to attempt to rectify breaches or transfer the Project Agreement. The Senior Lenders are given this opportunity under the terms of the Funder Direct Agreement. In such circumstances, the Senior Lenders are incentivised to take control of the Project because any failure to do so will lead to termination of the Project Agreement.

Senior Lenders accept that they should take the risk of PPP Co's performance and take responsibility for the Project if the Authority elects to terminate the PPP Co for poor performance. The Senior Lenders will not, however, agree to any requirements to take reasonable steps to transfer the Project Agreement to a third party at the time of the issuance of the Termination Notice if there is no liquid market for similar types of projects. The recommended approach is therefore that if at the time the Authority issues the Termination Notice the parties agree that there is no liquid market (or it is determined in accordance with the Dispute Resolution Procedure), the procedure set out in Paragraph 3 (No retendering Procedure) should be used to determine the compensation payable to the PPP Co.

Retendering Election and Liquid Market

The Authority is given a choice whether to retender the Project Agreement or not following termination. It would not be appropriate for the Authority to choose between these two methods of compensation if:

1. there is no liquid market for similar PPP projects; or

2. the Senior Lenders have stepped in and are using their reasonable efforts to find a buyer for the Project Agreement.

The Authority should, however, in other circumstances have the right to elect whether to require retendering of the unexpired term of the Project Agreement or to have the Project Agreement valued on the basis of there being no retendering.

If there is no liquid market for the Project Agreement or similar contracts, and the Project Agreement terminates then the procedure set out below (No Retendering Procedure) should be used.

There will be a liquid market for the Project Agreement if there are a sufficient number of contractors in the prevailing PPP market (or markets for similar contracts to PPP contracts) to ensure that the price that a contractor will offer for the Project Agreement is reasonably likely to represent a fair value.

The question is whether the market for contracts of this type in general is liquid (it is possible for there to be no bidders for a retendered Project Agreement and there still to be a liquid market). If the Authority only receives one compliant tender then the amount that the compliant tenderer bids for the new contract should not automatically be rejected as not representing the fair value of the new contract. The relevant test is not what happens at the end of the Retendering Procedure, but the state of the PPP market for similar contracts at the time the liquid market test is run. If there is a liquid market for PPP and the Authority elects to retender the Project Agreement, the market will determine the Fair Value of the Project Agreement (i.e. if there are no bidders for the Retendering of the Project Agreement, the market has, by definition, determined that the market value of the Project Agreement is less than or equal to zero). The Senior Lenders are therefore incentivised to exercise their rights under their Funder Direct Agreement with the Authority to ensure greater control by means of Retendering of the Project Agreement.

If the Project Agreement is transferred to a new contractor via the Retendering Procedure, the price for which the Project Agreement is to be sold will be determined through a competitive bidding process, controlled by the Authority. The Senior Lenders will generally prefer to control any transfer of the Project Agreement, and the price achieved for the transfer, themselves. This they are permitted to do by stepping in under the Funder Direct Agreement. Accordingly, the Senior Lenders are incentivised to exercise their rights of step-in and take control of the sale of the Project Agreement to a new contractor.

Any dispute as to the existence of a liquid market for the Project Agreement should be dealt with through the dispute resolution procedure.

Retendering Procedure

The Authority will in the circumstances referred to above (Retendering Election) be entitled to elect to sell (i.e. retender) the unexpired term of the Project Agreement on its original terms and pay the proceeds of the sale (net of the Authority's costs) to the former PPP Co.

Bidders would be invited to tender to the Authority for the provision of the Services set out in the Project Agreement at the same Unitary Charge as that set out in the Project Agreement. Since both the Services and price remain unchanged, the Authority wil be no better and no worse off than it would have been had the Project Agreement not been terminated, save for the disruption caused. If the Authority wishes to retender the Project Agreement on the basis of different Services, then the Authority will need to agree with PPP Co. (and its lenders) any changes which would adversely affect PPP Co., or alternatively pay the Adjusted Estimated Fair Value of the Contract.

The Unitary Charge should be sufficient, in most circumstances, to represent a positive valuation from prospective bidders (and so generate a cash sum) since, particularly if termination takes place during the Service Period, bidders will not typically incur capital costs on the scale envisaged when the price was originally agreed. The private sector is, of course, familiar with the cash flow valuation techniques which would be used to assess the value of the Project Agreement. These involve their valuing a number of factors, including the revenue stream of the Project, the capital and service costs they expect to incur (taking into account the conditions of the Assets), the perceived risks associated with the Project, financing costs and market appetite.

One of the concerns that the outgoing PPP Co. will have is that, in the period between the Termination Date and the date of the New Contract, there will be no income, finance costs will increase, the condition of the Assets may deteriorate (thereby detrimentally affecting their value) and the Authority will potentially be obtaining some value even though there is no service (in that, even with the Authority itself performing the Service, a significant benefit exists). For that reason, the Authority should periodically pay a Post Termination Service Amount to the outgoing PPP Co which should approximate to the value received in this interim period. The recommended approach is to take the Unitary Charge that was paid at the Termination Date and deduct from that both the costs of alternative provision of the Service and any rectification costs (allowing the PPP Co. the benefit of any rectified availability as a result of rectification costs being incurred).

To the extent that the term of the New Contract is the same as the unexpired term for the terminated Project Agreement (i.e. the expiry date in the New Contract is later than that in the Project Agreement by the amount of time the Retendering Procedure has taken) then any Post Termination Service Amounts should be deducted from the ultimate payment made. That is, once the estimated value of the post termination period to the Authority has been accurately assessed, this deduction is appropriate.

However, for operational reasons it may be that a service requirement can, in fact, only be delivered for a period that expires on the original Expiry Date. In such circumstances, it would not be possible for the term of the retendered contract to be for a period equal to the unexpired term of the Project Agreement. If it is not possible to relet for a period equal to the unexpired term (e.g. the Expiry Date of the original Project Agreement is the date on which the Service ceases to be required) then the Post Termination Service Amounts should not be deducted from the Market Value of the Contract.

As in the original procurement, the Authority will select the bid which represents best value (which should not simply be the highest price). Given the need for the outgoing PPP Co. to be protected and to give the Authority flexibility, the highest priced compliant tender is the amount paid by the Authority to the outgoing PPP Co. in compensation, even if the Authority decides to contract with a separate compliant tenderer offering better value for money and which has agreed to pay a lower price. In such a situation the Authority will have to have satisfied itself as to the value for money benefits of choosing such a tenderer. All things being equal, and provided bidders are able to show that they are capable of meeting the service requirements, the best priced compliant bid should win. The bid price, net of the Authority's own costs of Retendering and any costs incurred in relation to running the Service prior to replacement of the PPP Co. (having taken into account non-payment of the Unitary Charge), will be paid to the former PPP Co. as compensation (this is defined as the Adjusted Highest Compliant Tender price in the drafting).

It is important that neither party is incentivised to delay the process by which market value is determined. These provisions help prevent such a delay occurring.

If the Authority elects to retender the Project Agreement, the Authority will be responsible for and will control the Retendering process. Consequently, if the Senior Lenders decide not to step in, or have subsequently stepped out they will cease to have any control over the transfer of the Project Agreement to the new contractor. However, the Senior Lenders will be concerned to ensure that the Authority correctly follows the Tender Process so as to help ensure that a fair market value for the Project Agreement is received. The Senior Lenders (through PPP Co.) should therefore have the right to appoint a third party (the "Tender Process Monitor") to monitor the retendering process and report on its progress to PPP Co. and Senior Lenders. Although the Tender Process Monitor should have the right to attend meetings, review tender process documentation and bids, the Authority should not be required to have regard to any representations made by the Tender Process Monitor in respect of the Tender Process.

No Retendering.

Alternatively, either the Authority may elect not to retender the Project or it may be that there is no Liquid Market, in which case the Authority will instead pay to PPP Co (from its own resources) an assessed value of the amount it would have received through an appropriate retender process (net of costs) that is, if a Liquid Market had existed (the “Estimated Fair Value of the Contract”).

Estimated Fair Value computations are conducted by forecasting the full Unitary Charge from the date of termination to the expiry of the Project Agreement (ignoring any deductions for performance or availability), from which the estimated costs of delivering the service to the required standard in the output specification (this includes the running costs, lifecycle costs and any rectification costs) are deducted to arrive at the estimated operating cash-flow stream which, had a liquid market existed and the project been re-tendered, a hypothetical bidder would have valued to determine the amount to bid for the project.

The first point to consider in making this computation is whether this computation should be conducted in nominal terms (i.e. using current prices) or in real terms (i.e. using constant prices). For contracts with 100% indexation to RPI, it should not normally matter since both methods would return the identical result. However, it is easier and safer to conduct the analysis in nominal terms because:

(a) many elements of a project (including tax and cost of funds) are always quoted in nominal terms, and it is easy to make errors by ignoring this when conducting “real” computations, and

(b) the majority of PPP contracts let in the PPP market are partially indexed. For such contracts, the “real” value of the Unitary Payment 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.

The calculation must also take care to ensure that if the forecast cash flows are expressed in nominal terms (i.e. taking indexation into account), the discount rate used must also be expressed in nominal terms. The discount rate is usually made up of a “real” rate of return, on top of which an allowance for inflation is added.

The next question is whether the Estimated Fair Value analysis should be conducted in pre- or post-tax terms. It is considerably easier and more transparent to conduct the analysis in pre-tax terms because this avoids protracted scrutiny of the assumptions underlying the tax forecasts.

The forecast cash-flows should be discounted at a discount rate which reflects the risk of the underlying cash-flow. The most transparent measure of the risk of the cashflows is the real pre-tax project IRR reflected in the Base Case.

Schedule 17 – Part 2 – Termination for Authority Default and Voluntary Termination

The objective should be to ensure that PPP Co. and its financiers are fully compensated i.e. no worse off because of Authority Default or Voluntary Termination than if the Project Agreement had proceeded as expected.

PPP Co. should be required to specify its preferred method of calculation of equity return at the time of its bid. It should choose between the level set out in the original base case, the market value at the time of termination and the original base case return from the Termination Date.

In many PPP projects, equity is invested as a blend of share capital and junior debt. In calculating Authority Default compensation, many projects have distinguished between junior debt and equity. Typically, junior debt has been repaid in full (together with interest) while compensation for equity has been based either on its market value or on a base case return. Mezzanine debt has not been specifically identified. If the project concerned does have an element of mezzanine debt then the Authority will have to consider the extent to which, for the purposes of Authority Default or Voluntary Termination, it is more akin to Senior Debt or equity and decide upon an appropriate approach for termination compensation.

Since in many PPP projects, much of the "equity" is invested as junior debt, the approach taken in the early PFI projects in the UK was to give PPP Co. the opportunity of equity upside (through the market value compensation) but insulate it from downside (since junior debt is repaid in full). This is not appropriate. It is important that the same method of calculation (whether "market value" or "base case return") is used for both equity and junior debt.

For similar reasons, calculations based on the higher of base case return and market value" (giving PPP Co. all upside but no downside) or the lower of base case return and market value" (giving the PPP Co. all downside but no upside) are inappropriate.

Bidders should be invited to bid which of the following levels of equity/junior debt compensation they prefer:

Compensation to reflect the base case IRR for equity and junior debt for the entire duration of the Project Agreement. The purpose is to provide equity investors 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 to equity (in dividends/redemption payments etc) and junior debt (in interest and principal repayments) taking account of the actual timing of all such payments, provides equity and junior debt with their base case project-life IRR as agreed on signature of the Project Agreement up to the Termination Date. Where equity or junior debt have already hit their project-life base case IRR, no payment should be made.

Compensation to reflect the market value of both equity and junior debt for the entire duration of the Project Agreement. The purpose is to allow the equity investors to take the full benefit of good PPP Co. performance but bear the risks associated with poor performance.

The Authority pays an amount for both equity and junior debt based on their market value on a going concern basis immediately prior to the termination i.e. the amount for which the equity and junior debt could have been sold to a willing buyer at the relevant date (the calculation being based on the assumption that there had been no Authority Default and that both equity and junior debt were freely transferable).

The market valuation will reflect the value of anticipated future cashflows (both revenue and costs); risk allocation under the Project Agreement; and market appetite for contracts of a similar nature. It will also take into account the value of the Assets (including any cash balances) held by PPP Co. at the Termination Date.

Compensation to reflect the base case return for equity and junior debt for the remainder of the duration of the Project Agreement. This is an amalgamation of the first two approaches. The compensation payment is the amount of future return that the equity and junior debt providers originally provided for in the base case bid.

Care should be taken that if a refinancing has occurred (see Section 35 (Refinancing)) and the original equity and Junior debt reduced, there is no double counting.

PPP Co. is likely to incur redundancy costs as a result of the termination of the Project Agreement and, to the extent that these will occur, these should be included in the compensation payable by the Authority. Similarly, the Sub-Contractors may incur losses as a direct result of the early termination of the Project Agreement (e.g. in respect of cancellation of orders for materials and goods). The Project Agreement should specify those heads of loss which the Authority will pay to PPP Co., on account of the Sub-Contractors' losses. If the Authority proposes to offer compensation to cover the Sub-Contractors' future loss of profits, it should limit the period of time for which it will pay for such future loss (e.g. for a one year period from termination) and satisfy itself (through conducting due diligence over sub-contracts or otherwise) that the quantum of the loss of profit and other consequential losses and breakage costs are reasonable and appropriate.

The Authority should also decide what happens to the Assets following a compensation payment. As the Authority has fully compensated PPP Co., they should usually revert to the Authority. Where the assets may have a significant residual value and PPP Co. retains the assets then different considerations will apply.

Schedule 17 –Part 3 - Compensation on Termination for Force Majeure, Uninsurable Risk or Change in Law

If the Project Agreement terminates for Force Majeure, Uninsurable risk or Change in Law, the Authority should pay Compensation on Termination to PPP Co. that reflects the principle that the circumstances are neither Party's fault and they should share the financial consequences. This is reflected in the Standard Project Agreement

Schedule 17 – Part 4 - Compensation on Termination for Corrupt Gifts and Fraud and Breach of the Refinancing Provisions

The only Compensation on Termination that should be paid in these circumstances is the Revised Senior Debt Termination Amount. Equity Holders should not be compensated as their relationship with PPP Co renders them responsible for its actions

Clause 40 – Handback

A distinction can be drawn between:

- Projects where the Project Facility will be owned by the Authority at the end of theTerm; and
- Projects where residual value of the Project Facility is best transferred to PPP Co. These are generally generic Assets which have alternative use outside the public sector and for which there is no clear long-term public sector need (for example, office accommodation in areas where there is demand from other users, generic information technology systems and alternative land use).

"**Residual value**" means in the context of a PPP Project, the market value of the Assets associated with the Project at the time it expires. When the Project Agreement is signed, the residual value of the assets is not known. "Residual value risk" refers to the uncertainty as to what the residual value will prove to be. There will usually be some estimate of the approximately residual value to be expected, which may be factored into the overall financing structure of the Project.

Assets where the Authority retains Residual Value on Expiry

In many PPP projects, the Authority's long-term objectives will be best served by retaining ownership of the Project Facility. The TPA is drafted on the basis that the Project Facility remains in the ownership of the Authority at all times and a licence is granted to PPP Co. for the Term of the Project for the sole purpose of enabling it to perform its obligations under the Project Agreement.

This may be because:

- legal constraints prevent any practical alternative option, for example the private sector cannot be a roads authority so roads must revert to the public sector Authority;
- contracts which involve Project Facilities, such as hospitals and schools, are specifically designed to cater for a particular service. In these sectors, the Project Facilities have a useful economic life if retained by the Authority but there is no realistic alternative use for the Project Facility. There may be only limited scope for alternative use on expiry of the Term and conversion is likely to be costly;
- the Authority requires long-term use of the Project Facility for the continued provision of its services; or
- bidders are likely to discount the residual value of the Project Facility.

In most cases in which the Authority remains the owner of the Project Facility at the end of the Term, the Authority should consider the extent to which it should have recourse to PPP Co. if the condition of the Project Facility reveals that PPP Co. has not carried out all its contractual (for example, maintenance) obligations. This would not be necessary if Assets had reached the end of their useful economic life (as may be the case, for example, in equipment based projects).

Transfer of Residual Value Risk

If the Authority does not need to own the Project Facility at the end of the Term and if transfer of residual value risk will enhance value for money, the Authority can pay a Unitary Charge which does not enable PPP Co. to cover the complete cost of financing its investment through the service payments it receives during the Term. PPP Co. instead has to rely on value being left in the Project Facility remaining on the Expiry Date or Termination Date to recover all such cost. This leaves some real risk with PPP Co. in relation to the residual value at the end of the Term.

The options exercisable by the Authority on the Expiry Date or Termination Date in relation to a Project Facility with an alternative use where PPP Co. is taking the residual value risk are:

- to take over the Project Facility, in which case a payment should be made to PPP Co.;
- to retender the Service, in which case the successful contractor in the retendering exercise should make a payment to PPP Co. reflecting the value of the Project Facility; or
- if the Authority has no further use for the Project Facility, to walk away at no further cost, leaving PPP Co. to realise their value.

Each option has real economic value to the Authority, as the NPV of the total payments made under the Project Agreement should be lower than if the residual value risk had been retained.

Valuation of Terminal Payment on Expiry where Residual Value Risk has been Transferred

The two main options for determining amounts payable at the expiry of the Term in respect of Assets with an alternative use are:

- the market value of the Assets in their existing use; and
- an amount bid by PPP Co. when negotiating the original Project Agreement indexed through the duration of the Term.

The market value of the Assets is the more valid basis for a payment to be made at the end of the Term. If, however, there is a possibility of an extraordinary increase in market value during the duration of the Project and the Assets are critical to the Authority's needs (i.e. the Service cannot be obtained without them) then a cap on the amount payable may be prudent (for example, to guard against excessively inflated property prices).

The mechanism for arriving at the market value must be specified in the Project Agreement to avoid a dispute over the valuation. The final amount will reflect the condition of the Assets.

Part 13 – Compensation Events, Relief Events and Force Majeure

PPP Co. undertakes to ensure Service Commencement usually by a particular fixed date and to continue to provide the Service for the duration of the Project Agreement. There may, however, be circumstances in which PPP Co. should fairly be relieved from liability for failure to commence or provide the Service. A balance must be struck between encouraging PPP Co. to manage the risk and protecting the Authority from non-performance.

Supervening events for which some relief is appropriate should be divided into three categories:

- Compensation Events – i.e. events which are clearly at the Authority's risk and in respect of which PPP Co. should be compensated;

- Relief Events – i.e. events which are best managed by PPP Co. (although not necessarily in its control) and for which PPP Co. bears the financial risk, but in respect of which no rights of termination should arise; and

- Force Majeure Events – a limited set of events which arise through no fault of either Party, which are best managed by PPP Co. (although not in its control) and in respect of which rights of termination can arise.

The distinction between Compensation Events and Relief Events is sometimes expressed as being the difference between PPP Co. being given 'time and money' and 'time' only.

Certain events may be dealt with differently in specific projects, depending on the nature of the Project, the likelihood of the event occurring and the value for money obtainable if PPP Co. prices the risk of such event occurring into its price. Given the effect on the Authority of adding risks to Compensation Events, this should only be done after careful consideration in specific cases. For example, in a project in which the Authority use means that delays during the construction phase are a high risk, the Authority may accept that the event leading to such increased risk should be a Compensation Event. In a project where such risks do not exist, the Parties may agree that a Relief Event is the way to deal with that risk. An alternative way of dealing with the risk of discovery of fossils or antiquities during the construction phase, which lies somewhere between the Compensation Event and Relief Event approach, is for PPP Co. to bear a pre-determined initial level of loss (both financial and in terms of delays to the construction timetable), as defined in the Project, with further losses above that prescribed level being shared by the Parties in accordance with an agreed formula.

Clause 41 – Compensation Events

See above

Clause 42 – Relief Events

Relief Events are events which prevent performance by PPP Co. of its obligations at any time, in respect of which PPP Co. 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 Service. The events listed in this standard Project Agreement may be outside PPP Co.'s control, but that is not the appropriate measure of whether an event should appear on the list, as many events beyond a person's control at the time they occur could in fact have been prevented by proper precautions (e.g. fire). In fact, the list of events has been arrived at because the risk of the events concerned occurring is better borne by PPP Co. as it is in a better position than the Authority to mitigate and manage the consequences. In some cases this will be with insurance, in other with a combination of insurance and proper planning and in others still, by risk management and planning (i.e. the events can be worked around for the period they exist).

It is clear in most cases that termination should not follow a Relief Event. This is because any replacement PPP Co. would be similarly affected and so the Authority's position would not be improved by Termination. Relief Events do not, however, require the same treatment as Force Majeure Events as their consequences are not likely to be as severe and will usually only last for a finite period.

Clause 43 – Force Majeure

The purpose of force majeure provisions is to give the Affected Party relief from liability and, if the event continues for a certain period, to give the parties an opportunity to terminate the Project Agreement. The definition of Force Majeure Event should only include events which, unlike Relief Events, are likely to have a catastrophic effect on either Party's ability to fulfil its obligations under the Project Agreement. In practice, such events are highly unlikely to occur. As neither party is likely to be in a better position than the other to manage either the occurrence or the effects of force majeure, and the events may continue for a long period of time, such events are given a different treatment from Relief Events and the financial consequences shared.

Clause 44

This should be considered on a project specific basis.

Clause 45 – Insurance and Schedule 23 Required Insurances

Following review by NDFA of treatment of insurance in PPP projects, the insurance regime and provisions contained in the TPA have been based upon the UK Standardisation of PFI Contracts Version 4 ("SOPC4") model, amended to reflect circumstances of Ireland's PPP programme as appropriate. Rather than replicate the detailed notes that are available to explain the rationale and application of these principles and insurance drafting they can be best found by referring to SOPC4 Chapters 25 (Insurance) and 32 (Commitment Letters). The link to the detailed insurance comments of SOPC4 can be accessed via www.hm-treasury.gov.uk/documents/public_private_partnerships/PPP_index.cfm. Insurance provisions in the TPA are made up of Project Agreement Part 15, Clause 45 (Insurance), Schedule 1 (Definitions) and Schedule 23 (Required Insurances). The ITN should also contain detailed bidder insurance requirements for response matrices (insurance technical, insurance premiums and insurance costs).

Fundamental to the PPP process is the aim to achieve optimum allocation of risks between the public sector and the private sector so that risks are placed where they can be most effectively managed and controlled. Insurance, being itself a risk mechanism, plays a role in the exercise of allocating project risks.

Each project will have an individual insurable risk profile and it is essential that insurance advice is sought as to the precise requirements for the Required Insurances before the Project Agreement or ITN is sent to bidders. The insurance provisions in each project will need to reflect accurately the risk allocation or risk sharing between the parties in relation to insurable risks relating to the subject matter of the project.

The Authority must require that certain insurances are taken out and maintained (e.g. throughout the construction and operational periods of a project) to ensure that insurance proceeds are available to cover certain types of losses or claims.

In the assessment of the nature and applicability of any Required Insurances in a project, consideration of the following issues will be required and should be reflected as appropriate in the Project Agreement and ITN:

1. An insurable risk plan for the project in question which will create an audit trail validating the project requirement and allocation of insurable risks.

2. Required Insurances policy scope and the viability of these in prevailing insurance market conditions for the subject matter of the project in question.

3. Adequate protection of the Authority's separate insurable and other interests.

4. Authority rights relative to any Required Insurances.

5. Obligations on the PPP Co. relative to maintenance of the Required Insurances throughout the period of the project and the project term.

6. Insurance negotiation strategy for the project including validation of the Bidders insurance costings for the ITN and any BAFO. This will include the mechanism to deal with insurance premium cost volatility and premium movement risk throughout the life time of the project.

7. How to deal with Uninsurability and Unavailability of Terms and Conditions in relation to the Required Insurances.

8. Whether project specific or use of Bidders existing insurance arrangements are to be utilised. The TPA insurance provisions are currently generally predicated on a project specific insurance regime.

9. Assessing appropriate Limits of Indemnity, Sums Insured and basis of settlement relative to project risk exposures.

10. Assessing appropriate Maximum Deductible/Excess levels relative to project risk exposures.

11. Financial security of insurers and Authority insurer approval.

12. Obligations on the placing insurance broker via a Brokers Letter of Undertaking.

Clause 46 – Indemnities

This should be looked at on a project specific basis by the Authority's legal advisers.

Clause 47 – Refinancing

In the TPA, the Authority will receive a 50% share of any refinancing with respect to Senior Debt. In the case of Junior Debt, bidders should be asked to bid how much of a Refinancing Gain they are prepared to share with the Authority, subject to a floor of 50%.

Part 16

Clause 48 - Assignment, Clause 49 - Change in Control and Clause 50 - Sub-contractors

These clauses must be looked at on a project specific basis.

Part 17 – Miscellaneous

Clause 51 – Visitors

Boilerplate

Clause 52 – Confidentiality

Boilerplate

Clause 53 – Public Relations and Publicity

Boilerplate

Clause 54 – No Agency

Boilerplate

Clause 55 – Notices

Boilerplate

Clause 56 – Custody of the Financial Model

To be reviewed on a project specific basis.

Clause 57 – Data Protection

Boilerplate

Clause 58 – Costs and Expenses

Boilerplate

Clause 59 – Financial Standing of PPP Co.

Boilerplate

Clause 60 – Waiver

Boilerplate

Clause 61 – Sever ability

Boilerplate

Clause 62 – Entire Agreement

Boilerplate

Clause 63 – Variation

Boilerplate

Clause 64 – Language

Boilerplate

Clause 65 – Counterparts

Boilerplate

Clause 66 – Governing Law

Boilerplate

Clause 67 – Jurisdiction

Boilerplate

Clause 68 – Waiver of Immunity

Boilerplate

RISK MATRIX

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
1.	**SITE RISK**					
1.1	Planning				X	Where the Authority provides the site on which the Project Facility is to be built, it makes sense to obtain outline planning permission to ensure, in advance of the tender process commencing, that the Project is feasible. The Preferred Bidder will then be responsible for obtaining full planning permission on the basis of his detailed design.
1.2	Physical Condition	5.2 5.6 5.7(iii) 6.2	X			The Authority normally passes the risk associated with the condition of the site (being the risk that adverse ground conditions could cause increases in cost and/or construction delays) to PPP Co. This position is reflected in the TPA. PPP Co. will in turn pass the risk to D&C Co. D&C Co. will mitigate its loss by way of due diligence on the site and site surveys to ensure an appropriate construction bid is compiled. If the information turns out to be wrong, then the risk of increased costs or delays lies with D&C Co., who would also indemnify PPP Co. against any impact of delay.
1.3	Sufficiency of Title					In an accommodation project where the site is

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						provided by the public sector, it should assume the risk of providing a site with good title. It may not, however, be possible to give a full warranty as to title and a warranty as to the accuracy of replies may be more appropriate. This must be looked at by a property lawyer in the context of the Project and the site involved.
1.4	Access to Site	5.5(b) 6.2		X		In an accommodation project where the site is provided by the public sector, it should assume the risk of providing a site to which PPP Co. will have unimpeded access to commence the Project. Where the PPP Co. does not have control over the site, it cannot manage the risk associated with access, for example from protestors. To transfer this risk to the private sector in an accommodation project would be poor value for money for the Authority. The TPA assumes that the public sector will take the risk on access until such time as PPP Co. is granted a licence to the site and commences work on the Project.
1.5	Environmental risk		X			This has been passed to PPP Co. and would normally be passed down from PPP Co. to D&C Co. However, depending on the nature of the site and the project, it may be

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						appropriate to include environmental contamination in the Relief Events. This would be appropriate where comprehensive examination of the site is not practicable or cost effective or if there are pre-existing services on it. In such circumstances it may prove to be more effective for the public sector to treat contamination as a Relief Event which would give PPP Co. an extension of time to remedy the issue so as to avoid payment of damages and/or possible termination, whilst the associated costs would remain PPP Co.'s risk, mitigated by insurance. However, as with site risk, the public authority should consider whether it represents value for money to pass this risk. If it has owned and operated from the site for some time, it may choose to retain the risk and thus lower the cost of the project. The TPA assumes transfer of this risk to the private sector but has included Environmental Contamination as a possible Relief Event.
1.6	Archaeological risk	6.3			X	This is a particularly sensitive issue in Irish projects. Depending on the nature of the site and project, it may be appropriate to include this in the list of Relief Events. Alternatively, a

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						risk sharing approach to cost could be used. The standard Project Agreement includes Archaeological Discoveries in the list of Relief Events and offers a cost sharing option. However, the public sector should always consider on a case-by-case basis, whether it would be better value for money to bear this risk itself.
2	**DESIGN AND CONSTRUCTION RISK**	7-16	X			PPP Co. is responsible for the design, construction, integration, installation, testing, commissioning, operation, maintenance and ultimate performance of any asset procured or developed for the purposes of meeting the requirements of the Output Specification. The Authority should not (save in exceptional circumstances) take any responsibility for this risk. Correspondingly, PPP Co. should be afforded the freedom to manage its activities without interference from the Authority. It is PPP Co.'s risk whether the design and development it has carried out are capable of satisfying the Authority's service requirements. The Authority should not, save in exceptional circumstances agree to any role before or following Service Commencement which involves the Authority taking back any part of PPP Co.'s design and construction risk.

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						In this context, the Authority should not make payments against construction milestones nor should it have a right of termination for failure by D&C Co. to meet a Construction milestone. The Authority's role after signature of the Project Agreement and prior to Service Commencement will normally include: • reviewing and commenting upon PPP Co.'s designs, maintenance and operational procedures as they are developed; • viewing and observing tests of any equipment being developed; • following the agreed procedure by which PPP Co. demonstrates to the Authority that Service Commencement can be accepted; • following the agreed procedure in relation to a failure to meet the Service Commencement Date and agreeing with PPP Co. the measures to be taken and the financial consequences if any; and

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						• auditing PPP Co.'s activities in accordance with an acceptable Quality Management Systems regime. It must be made clear in the Project Agreement that all of these tasks are carried out without any approval from the Authority in the sense that the Design or Works as constructed or finalised will be capable of meeting the Output Specifications.
3	**DEMAND RISK**	24 Schedule 15		X		The TPA leaves demand risk with the Authority. In an accommodation project such as a school, hospital or prison, where the private sector has no control over the number of users, it would not be good value for money to transfer such risk.
4	**AVAILABILITY AND PERFORMANCE RISK**		X			The payment mechanism is based on a Unitary Charge which is payable only when a unit (classroom, cell, etc.) is available in accordance with the standards set down in the Project Agreement. Deductions will be made for unavailability or substandard performance. For example, if the toilets in a prison are flooded, they will be unavailable and PPP Co. will suffer a predetermined deduction from the Unitary Payment for that month. However, if the toilets have not been cleaned,

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						PPP Co. will suffer a lesser Performance Deduction as the toilets can still be used.
5	**CHANGE IN LAW**					
5.1	Discriminatory change in law	30 Schedule 21			X	Under more traditional commercial contracts, PPP Co. is usually able to pass on the costs of changes in law 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 changes in law arising during the term of the contract. As the prices in PPP contracts are agreed on a long-term basis and are not flexible in the same way, PPP Co. will often not be in a position to price the full cost of changes in law effectively. A sharing approach is the best way to ensure that the costs of implementing changes in law are minimised. The approach set out in the TPA in respect of the sharing of risks relating to changes in law is intended to play to the strengths of both the public and private sectors and ensure that PPP Co. is incentivised to manage its costs, even where the Authority agrees to meet PPP Co.'s costs resulting from complying with a change in law.
5.2	General Change in law involving	30 Schedule 21			X	This is primarily a public sector risk as PPP Co. has no control over such matters and the

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
	capital expenditure during the Service Period					Authority will receive the benefit of the capital output. The private sector is asked to bid a small sum to avoid claims being made that cost more to process than they are worth to the private sector.
5.3	General Change in Law (other than as referred to at 5.2 above)	30 Schedule 21	X			The private sector bears this risk on the basis that any service contractor will be in the same position and these changes will in any event be absorbed via benchmarking.
5.4	Change in VAT	27		X		The public sector should bear this risk as PPP Co. has no control over it and there is no point in the public sector paying a risk premium to transfer it.
6	**RESIDUAL VALUE**		X			In most PPP projects, the Authority's long-term objectives will be best served by retaining ownership in the Project Facility. The TPA is drafted on this basis. This should be the case where: • legal constraints prevent any practical alternative option, for example the private sector cannot be a roads authority so roads must revert to the public sector Authority; • contracts which involve Project

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						Facilities, such as hospitals and schools, are specifically designed to cater for a particular service. In these sectors, the Project Facilities have a useful economic life if retained by the Authority but there is no realistic alternative use for the Project Facility. These may be only limited scope for alternative use on expiry of the Contract Period and conversion is likely to be costly; • the Authority requires long-term use of the asset for the continued provision of its services; or • bidders are likely to discount the residual value of the assets.
7	**MAINTENANCE RISK**	17 18	X			PPP Co. will base its costings on a forecast capital replacement programme of plant, machinery, equipment, fixtures, fittings and furniture designed to maintain the building environment at the specified output standards. PPP Co. will also consider the means of funding this expenditure throughout the life of the Project. The risk associated with assessing what will need replacing, when and how much

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						this will cost, is one that PPP Co. should take and therefore the Authority should not attempt to be prescriptive in this respect. The Authority will wish to ensure that PPP Co. is as equally incentivised to maintain the Assets in the latter years of the Term as it is in the early years. The Authority should have the ability to conduct a final survey towards the end of the Term and withhold payment of the Unitary Charge if the Assets are not restored to the required maintenance standard. Maintenance should be left firmly at PPP Co.'s risk and the Authority should not attempt to prescribe the quantum, location or availability of a sinking fund. The Authority should consider whether it needs to take security over the sinking fund or whether it is adequately protected by the Project Agreement. For example, if the term of the Senior Debt is significantly shorter than the Term of the Project Agreement, the Authority may wish to have secured rights over a sinking fund once the Senior Debt has been repaid in full. If the size of the Project (including associated maintenance obligations) is comparatively

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						large in relation to the financial resources of a PPP Co. which is not relying on third party Senior Debt financing, the Authority may want to consider requiring a sinking fund over which it has secured rights.
8	**INSURANCE**	45			X	In order to ensure optimal risk transfer, the Authority should allow PPP Co. to manage its insurance arrangements as far as possible. However, the Authority must require that certain Required Insurances be taken out and maintained so that insurance proceeds are available in the event of a claim and to ensure that the Authority's separate insurable interests are fully protected. It is essential in every project that insurance advice is sought as to the precise requirements for Required Insurances before the Project Agreement/ITN is sent to bidders. The insurance costs are an integral part of the bid and the insurance provisions require the Authority to have full transparency and detailed insurance cost calculations (these to be accurately reconciled in the Financial Model). Every project is unique as far as insurance is concerned and the Project insurance regime must therefore be reviewed in detail to reflect

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						the insurable profile of the project in question.
8.1	Increase in Premiums	45.7			X	It is not possible to place insurance to cover the full life of a Project Agreement. Whilst it may be possible to purchase insurance policies to cover the Construction Period (as long as the build period is not too long), Operational Period insurances are usually renewed on an annual basis. It is difficult to cost such insurance over the life of a Project and who should bear the risk of any increases has become an area of debate in PPP projects

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						given the potential for significant increases in insurance premia due to the cyclical and variable trading status of insurance markets. The TPA adopts the position in Standardisation of PFI Contracts Version 4 (“SoPC4”) with some minor amendments. This is a complicated area and should not be changed without consultation with the NDFA. In brief, the position involves agreement between the parties and the fixing of insurance costs at the Bid stage (via an agreed Base Cost). The Base Cost calculation is derived on a long run median level principle. The private sector then takes the risk of increases in premia due to defined general insurance market movements up to 30% above this figure. After that increases are shared, with the public sector taking 85% of the risk and the private sector taking 15%. The premium sharing mechanism also operates in a like manner for premium decreases below the Base Cost.
8.2	Uninsurability	45.4	X			The consequence of a Risk covered by a Required Insurance becoming Uninsurable, will depend on the type of Risk and whether either Party is responsible for the Uninsurability. Assuming that neither Party is

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						responsible for the Uninsurability, in the case of third party liability insurance becoming Uninsurable, the Authority may elect to act as “insurer of last resort” or terminate the Project Agreement. If the Authority elects to terminate, it must pay compensation to PPP Co. equivalent to that payable on a Force Majeure Termination. If the Authority elects to continue the Project and stand as “insurer of last resort” and the Risk materialises, the Authority must pay any claim on the same basis as the insurer would have and in addition Force Majeure compensation. If the Authority takes the Risk, and the Project Agreement continues, the amount of the premium previously paid should be deducted from the Unitary Charge. Continual Uninsurability is required to be tested periodically and if insurable again cover reinstated. Similar arrangements exist in relation to property damage or business interruption insurances other than the Project automatically continues with the Authority as “insurer of last resort” up to any loss occurring. On the loss occurring the Authority either pays the claim and continues the Project or terminates under Force Majeure.

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						The TPA also contains a mechanism to manage the circumstance when a Required Insurance policy term or condition becomes Unavailable. This relieves the PPP Co of contractual default but the consequences of the unavailability of the policy term or condition no longer being available are managed by the PPP Co.
9	**REFINANCING**	47			X	In the TPA, the Authority will receive a 50% share of any refinancing with respect to Senior Debt. In the case of Junior Debt, bidders should be asked to bid how much of a Refinancing Gain they are prepared to share with the Authority, subject to a floor of 50%.
10	**COMPENSATION ON TERMINATION**	39 Schedule 17			X	The Compensation on Termination provisions of the TPA should only be altered if there is a very project specific reason to do so.
10.1	Compensation on Termination for PPP Co. Default.	39 Schedule 17, Part 1	X			The amount of compensation payable on PPP Co. Default termination is one of the key commercial issues for all parties concerned. The market value approach adopted in the TPA is the recommended approach for all accommodation projects. It basically provides that on termination for PPP Co Default, the project is sold to the highest bidder if there is a liquid PPP market. If there is no such market,

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						the value of the unexpired Term is determined by an expert. The amount of the highest bid or the expert valuation is the basis of the compensation paid to PPP Co. The Market Value approach represents a balance between protecting the Authority's interest and not imposing unreasonable deductions on PPP Co. for its default. It also encourages the Senior Lenders to step-in and rescue the Project instead of simply relying on the termination payment to pay their outstanding debt. The Market Value approach facilitates the Senior Lenders right to step-in, manage and rescue or sell the Project if PPP Co. defaults, but, if they fail to do so, offer compensation on termination based on the market value of the unexpired Term.
10.2	Compensation on Termination for Authority Default and Voluntary Termination	39 Schedule 17, Part 2		X		The objective should be to ensure that PPP Co. and its financiers are fully compensated i.e. no worse off because of Authority Default or Voluntary Termination than if the Project Agreement had proceeded as expected.

No.	RISK	CLAUSE	PRIVATE SECTOR	PUBLIC SECTOR	SHARED	COMMENT
						PPP Co. should be required to specify is preferred method of calculation of equity return at the time of its bid. It should choose between the level set out in the original base case, the market value at the time of termination and the original base case return from the Termination Date.
10.3	Compensation on Termination for Force Majeure, Uninsurable Risk or Change in Law	39 Schedule 17, Part 3			X	If the Project Agreement terminates for Force Majeure, Uninsurable risk or Change in Law, the Authority should pay Compensation on Termination to PPP Co. that reflects the principle that the circumstances are neither Party's fault and they should share the financial consequences. This is reflected in the TPA.
10.4	Compensation on Termination for Corrupt Gifts and Fraud and Breach of the Refinancing Provisions.	39 Schedule 17, Part 4				The only Compensation on Termination that should be paid in these circumstances is the Revised Senior Debt Termination Amount. Equity Holders should not be compensated as their relationship with PPP Co renders them responsible for its actions.