KEY ASPECTS OF PPP AGREEMENT

CONTRACT MANAGEMENT PERSPECTIVE

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INTRODUCTION

Public-Private-Partnerships (PPP) is a method of working in which the public and private sectors cooperate and partner with each other to create infrastructure and/ or provide services to users. All PPP projects have multiple stakeholders such as the ULBs, citizens, private sector, and state and central governments.

- According to Department of Economic Affairs, Ministry of Finance, Govt. of India, "A Public Private Partnership (PPP) means an arrangement between Government or statutory entity or Government owned entity on one side and a private sector entity on the other, for the provision of assets and/or related services for public benefit, through investments being made by and/or management undertaken by the private sector entity for a specified period of time, where there is a substantial risk sharing with the private sector and the private sector receives performance linked payments that confirm (or are benchmarked) to specified, pre-determined and measurable performance standards".

- Erstwhile Planning Commission of India had defined "the PPP is a mode of implementing Govt. Programs/Schemes in partnership with the Private Sector. It provides an opportunity for Private Sector participation in financing, designing, construction, operation and maintenance of Public Sector Programs and Projects".

INTRODUCTION

Key attributes of a Public Private Partnership (PPP)

- A long term contract between Government and a Private Entity, under which the Private Entity provides or contributes to the provision of a Public Service.
- The Private Entity receives the revenue stream – which may be from Government budget, from user charges, or a combination of both. Therefore, the Agreement transfers risk from the Government to the Private Entity including Service Delivery, Demand Risk and Project Risk.
- The Private Entity must generally make the investment in the Project. Generally a "Special Purpose Vehicle" will be formed to Build, Maintain and Operate the asset for the Concession Period. The SPV signs the Contract/Concession Agreement with Government.
- The Government Provide land, existing assets, etc., and provide State Support
- At the end of Contract Period, transfer the associated assets to Government

PROJECT ARRANGEMENTS

We can broadly divide the value chain of any project into the following four activities.

1. Construction: This could include design and construction of the project or only construction based on pre-specified designs. Further, the construction contracts may be structured as simple rate contracts for items or as an output based contract wherein the constructed asset should deliver a pre-determined standard of service.

2. Operation and maintenance: while considering the responsibilities for operating the asset and delivering services to the public, it is important to lay down clear performance parameter which should be met. Parameters which could be out of the control of the private party should also be suitably identified.

3. Monitoring and regulation: The local body could directly monitor the performance of the private agency/ NGO. In cases where the performance of the private party is spread across, the community groups could monitor.

4. Payment for services: In some cases, direct payment can be made by the beneficiaries/ users to the private party. In some cases, the ULB will pay based on pre-agreed norms or services. There could be other combination as well. The key issue is who bears the risk for non-payment or under-recovery especially when user charges are to be paid by the consumers.

CONCESSION AGREEMENT

- Draft project agreement sets out the terms and conditions that govern the public entity and the private partner in a PPP arrangement. The draft project agreement comprises several sections or chapters and each of those sections set out terms and conditions pertaining to a specific aspect of project. There are multiple annexes or schedules attached to this main body of the draft project agreement which provide more details on some specific matters; for example, the technical and performance specifications for the project or other agreements relating to the project, etc.

- In the interest of the project, the private partner should disclose information such as copies of this project agreement, the maintenance manual, etc. to the public entity. The Model Concession Agreement (MCA) for development of National Highways under PPP framework includes a section on disclosure.

- The commonly used project agreements in PPP arrangements are Management Contracts, Lease Agreements and Concession Agreements. Of the three, Concession Agreements are the most standardised format of Agreements. This is because the MCA captures all the standard clauses and provisions that need to form part of the contractual arrangements between the public entity and the private partner.

CONCESSION AGREEMENT

- A Concession gives a private partner (referred to as the concessionaire in this format of a PPP arrangement) a bundle of rights such as developmental rights, operating rights, rights to collect user charges, etc. in return for certain specified obligations to be undertaken, including responsibility for operations and maintenance.

- The Concession Agreement is designed to identify the rights and obligations of the parties, the contracting Authority and the Concessionaire. The Concession arrangement is generally for a longer period of time typically ranging between 10-30 years. Under this arrangement, the ownership of the project asset remains with the Authority, while the constructive possession is passed on to the Concessionaire. At the end of the Agreement period, all the Project Assets, including the assets purchased by the Concessionaire for the purpose of the Project, revert to the public entity.

- In a Concession, the commercial viability of a project determines whether the payment is to be made by the private partner to the public partner (in form of revenue share/ Concession payment) or vice versa (in the form of grant/ annuity payment).

Efficient Contract Management originates from well structured Contract. i.e., a well structured Contract will be easily implementable (manageable).

WHY CONTRACT MANAGEMENT

- Being long term arrangements, PPP contracts are likely to face uncertainties and unforeseen developments.

- In order to be successful, a PPP contract needs to be effectively managed to ensure:

  - Concessionaire and Authority perform their respective obligations.
  - Unanticipated developments during the life of the concession are expeditiously resolved in an equitable manner.
  - Mutual differences if any are appropriately addressed and scope for disputes is minimised.
  - Residual disputes, if any, are settled in a time bound manner without adversely affecting service delivery.

A robust contract is a necessity but not sufficient condition for ensuring project outcomes.

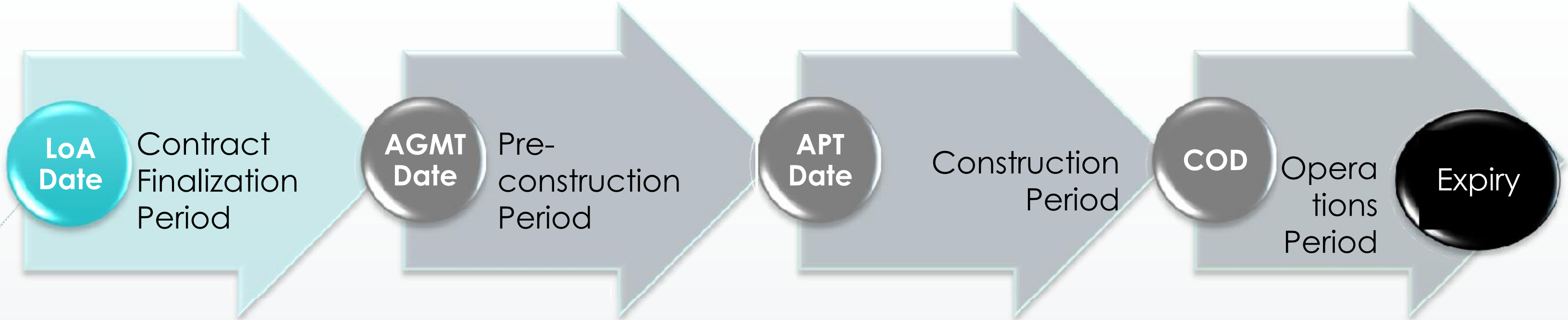
CONTRACT MANAGEMENT

Contract management involves:

- Defining the processes enabling both parties to meet obligations (Contract management plan)
- Monitoring performance of project in meeting stated objectives (Service delivery monitoring)
- Building a good working relationship (Relationship management)
- Anticipating and mitigating risks (Risk management)
- Suitably skilled resources (Contract management team)

The contract is unlikely to anticipate every circumstance that may arise and in some cases, it will be necessary for the parties to re-negotiate the contract. Approvals may be needed from third parties, such as a sector regulator, before an authority can enter into a material amendment.

ACTIVITIES TO BE UNDERTAKEN



Contract Finalization Period

The contracting Authority to:

- Finalize schedules and project specific information in the Contract
- Obtain performance bonds or guarantees from the private party
- Receive or make payments in terms of the contract
- For projects involving VGF and in case MCA is not applicable, then obtaining final approval from Empowered Committee/ Institution
- For Projects involving India Infrastructure Project Development Fund (IIPDF), recovery of funds from successful bidder.
- Obtain any corporate actions that are required for the private legal entity to sign
- Prepare the draft contract management plan

ACTIVITIES TO BE UNDERTAKEN

Pre-Construction Period

The contracting Authority to:

- Facilitate agreements to be entered into between private sector & Govt Entities such as State Support, Tripartite Agreement in case of VGF, or as applicable.
- Facilitate the Lead Financial Institution to submit project appraisal report to Government.
- Provide land free from encumbrances and other assets, as applicable.
- Make the necessary notifications in order to enable the private sector to perform its functions.
- Help the private sector in obtaining approvals, as applicable.
- Review private sector compliance with the Conditions Precedent.
- Appoint Independent Engineer (IE), Auditor, etc.
- Review the designs and construction plans, with assistance from IE. Ensure that IE confirms that the detailed drawings are in conformity with the proposed development plan.

ACTIVITIES TO BE UNDERTAKEN

Conditions Precedent

Contracting Authority :

- Unencumbered Right of Way
- Fee notification as required
- Railway approval in case of ROB/RUB
- Execution and procuring execution of the State Support Agreement
- Facilitating the Concessionaire for obtaining Central approvals & permits relating to environmental protection & conservation.

Concessionaire:

- Provision of Performance Security
- Execution and procuring execution of Escrow Agreement, Substitution Agreement
- Procurement of all applicable permits specified in the schedule to the concession agreement
- Execution of Financing Agreements
- Submission of Financing Documents, EPC contracts, O&M Contracts, shareholder funding agreements
- Delivering confirmation (of the Consortium Members) regarding the correctness of their representations and warranties
- Obtaining legal opinion on the authority of the Concessionaire to enter into the Concession Agreement
- Obtaining necessary Central approvals & permits relating to environmental protection & conservation

ACTIVITIES TO BE UNDERTAKEN

Construction Period

Authority Obligations:

- Provide remaining land as per project schedule

Service Delivery Management

- Undertake site-visits
- Review monthly and quarterly progress through IE inspection reports
- Through the IE perform tests prior to likely COD and provide for the Completion Certificate

- Review the continued fulfillment of mutual obligations and implement course corrections, if any
- Invoke contractual terms in case of non compliance by private party
- Monthly reporting on project status to relevant Government Authorities.
- Approve the Operations & Maintenance Manual submitted by the private sector

ACTIVITIES TO BE UNDERTAKEN

Operations Period

Service Delivery Management:

- Undertake site-visits.
- Monitor service delivery quality, safety, user satisfaction, and emergencies.
- Monitor that the maintenance (preventive, routine, periodic, major) is being done as per standards and in accordance with O&M manual.
- Review progress and performance indicators.

Contract Administration:

- Monitor financial performance, including revenues, revenue sharing, etc.
- Review the continued fulfilment of mutual obligations and implement course corrections, if any.
- Invoke contractual terms in case of non compliance by private party.
- Periodic reporting on project status to relevant Central Ministry / State Government.

ACTIVITIES TO BE UNDERTAKEN

Exit Stage

The contracting Authority to:

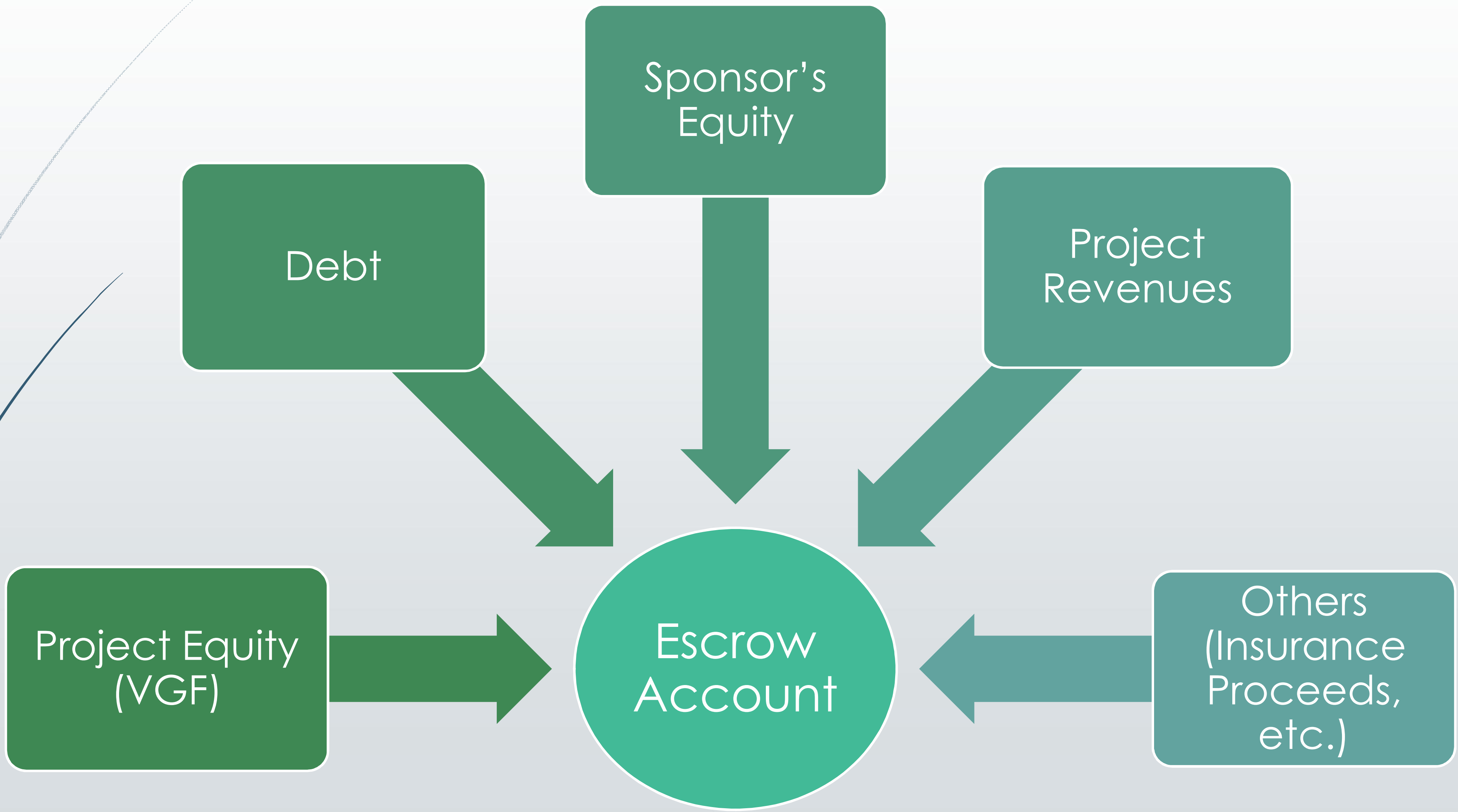
- Satisfy itself that the private party has met all the obligations set out in the contract
- Receive back all project related assets and resources from the private partner
- Issue vesting certificate to private party after taking over project assets
- Operationalise a team for taking over project operations
- In the event of appointing a new private party, complete the bid process and facilitate a smooth hand over from one operator to another

A FEW IMPORTANT CLAUSES

A few important Clauses (as applicable) are:

- Change of Scope
- Financial Close
- Concession Fee
- User Fee
- Escrow Agreement
- Insurance
- Force Majeure & Termination
- Dispute Resolution

ESCROW MECHANISM



OTHER AGREEMENTS

- An Offtake Purchase Agreement is executed between an offtake purchaser and the private partner. It secures the project payment cash flow and obliges the offtake purchaser to procure a certain amount of project output or pay for an amount of project service, whether or not it is used, over a given time.

- The Offtake Purchase Agreement may provide sanctions if the private partner/project company fails to deliver output as promised, particularly if the construction of the project is not finished on time or does not perform as required when completed. The offtake purchaser will typically look for a guaranteed long-term output from the project. One example of an Offtake Purchase Agreement is a "power purchase agreement" between a private power producer and State power distribution companies.

- Other Project Agreements are Construction Contract, O & M Contract, Lenders Agreements, etc.

CRITICAL SUCCESS FACTORS

- Create an enabling environment where the contract is viewed as a "partnership".
- Deploy a Contract Management team with the requisite skill set.
- Clearly define project objectives and effectively communicate the same to create a shared understanding.
- Having a well structured contract which clearly delineates roles and responsibilities.
- Put in place the necessary Contract Management framework.
- In case of long term projects, effective Contract Management would mean adapting to the changing business environment.
- Undertake continuous monitoring and review of Contract Management plan.

CRITICAL SUCCESS FACTORS

- Continuity of the team through all stages of the project - procurement stage to implementation and monitoring stage.
- Detailed knowledge of contract and related issues such as service levels & private party performance.
- Requisite skill set, both technical and interpersonal.
- Clearly detailed job description, objectives and team performance management systems.
- Necessary authority in line with job description to carry out contractual obligations.
- Clearly defined reporting lines.

FAILURE OF CONTRACTS – A FEW REASONS

- Delayed clearances, acquisition/ provisioning of land and aggressive bidding (overestimation of Demand) are major factors for failure of the Contracts;

- Delays escalate costs for the private operator(s) with no associated safeguards.

- Technical data availability and its quality has been a constraint in several PPP Projects;

- Other reasons are: poor Project preparation, improper risk sharing, inappropriate business model and fiscal delays and dearth of competent operators;

- A closed approach towards renegotiating Contracts and understanding the importance of Partnership (the 3rd P of PPP Projects);

- Going with the belief that once negotiated and entered into a Contract, ground conditions will continue to fold forever and any changes in Contract terms will attract charges of crony capitalism;

- Absence of Institutional mechanism as in some of the other countries to deal with negotiations.

CONCLUSIONS

- Audits of PPP Programs in the UK and Australia do suggest that PPP Projects result in lower costs and delivery expected to be on time and within budget.
- So far, India explored PPP in Energy and Transport with a significant success while China puts its emphasis in Public Service. In China, PPP is used for innovation where as we are using it basically to bridge the gap between Government fiscal capacity and the increasing Infrastructure demand.
- According to British National Audit Office (NAO) an assessment of the UK PPP policy in 2009 shows that 65% of the contracts were delivered on time and within the agreed budget.
- The Australian PPP market is one of the most well developed markets for PPP. The initial phase of PPP pertained to infrastructure projects that were modelled on the BOT and BOOT types. However, the focus of PPP shifted to social infrastructure in 2000s.

THANK YOU