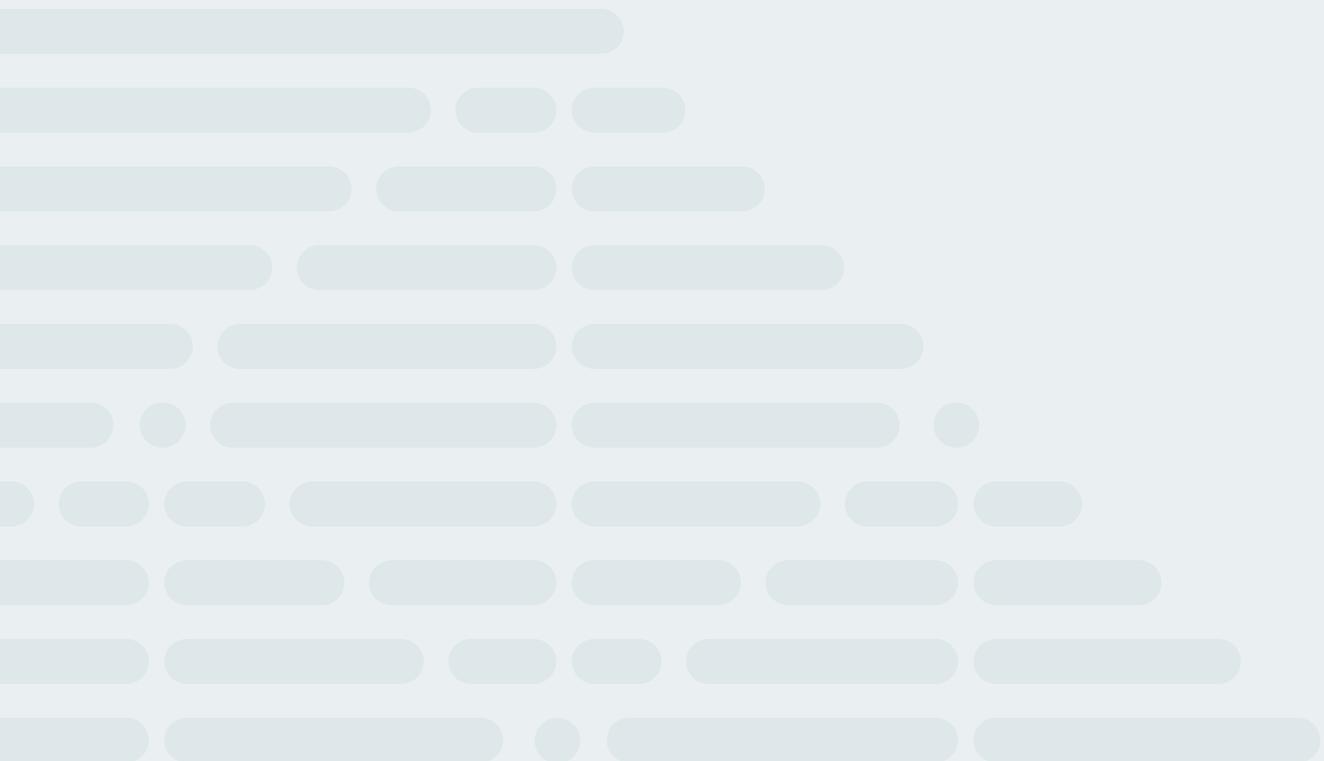


Default and termination



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7 Default and termination

Early termination refers to the termination of a PPP contract prior to the scheduled end of its contract duration. A PPP contract and the applicable laws will set out the circumstances which could trigger such a termination. An early termination event can typically be triggered by a serious breach of the provisions of a PPP contract by either the Project Company or the Procuring Authority.

An early termination event has the potential to trigger substantial compensation payments by the Procuring Authority to the Project Company. Such an event may leave a government with a half-completed asset, an asset that has no operator, or a reduction in the level of service being provided to end-users. A default can also indicate a failure in the contract management system.

A termination can also be triggered by the occurrence of an event that is not the fault of either party, such as termination due to a prolonged *force majeure* event rendering the parties unable to comply with the PPP contract. It is also common for the Procuring Authority to be entitled to terminate voluntarily at its own discretion.

It is important that PPP contracts are managed in such a way that the Procuring Authority is able to identify early indications of potential default and proactively mitigate the risk of termination, although it should be noted that it may not always be possible to prevent a default. Ultimately, the Project Company is responsible for complying with the PPP contract and there will be times, albeit rare, when the best decision the Procuring Authority can make in the circumstances is to terminate the PPP contract and take back the asset or re-tender the project.

The extent to which issues associated with PPP contract termination may be addressed within the legal framework of a particular jurisdiction (and the nature of the approaches commonly used to deal with these issues) will depend on the legal system the jurisdiction has adopted, the existence of specific laws (including specific PPP laws) and the maturity of the PPP market. This chapter aims to address some of those nuances from a practical contract management perspective, rather than a legal perspective and it does not attempt to address specific legal frameworks.

This chapter focuses on serious breaches of contract and defaults. Other less serious breaches are detailed in other chapters and sections of the reference tool. For example, claims are detailed in

Section 3.4 (Claims), and the Project Company's performance is detailed in Section 3.2 (Performance monitoring). Managing defaults and termination may lead to disputes, which are detailed in Chapter 5 (Disputes).

CHAPTER STRUCTURE

This chapter provides a background to issues around default and termination of a PPP contract in Section 7.1 (Background) and provides guidance on managing defaults and termination. The key elements to successfully managing defaults and termination are summarised below and detailed in Section 7.2 (Guidance).

- A. Be aware of the rights of both parties and any agreed pre-termination procedures in the PPP contract and under the applicable laws
- B. Monitor potential Project Company defaults to manage termination risk at an early stage
- C. Consider termination and the full financial and non-financial implications of termination
- D. Seek legal advice before issuing a termination notice
- E. When terminating a PPP contract, plan early to ensure service provision is uninterrupted
- F. Where a substitute Project Company is required, consider all potential effects of the substitution
- G. Consider the Project Company's lenders including their potential step-in rights
- H. Consider step-in rights of the Procuring Authority
- I. Monitor and ensure compliance with the Procuring Authority's obligations under the PPP contract and the applicable laws
- J. Monitor the performance of key contractors, whose termination can present a significant risk to a project

Section 7.3 (Summary data analysis) provides a summary of data analysis with respect to default and termination in relation to PPP contracts.

7.1 Background

Early termination

Some common grounds for early termination include default by the Project Company, default by the Procuring Authority, as well as the occurrence of other specific events. The terminology globally for default and termination is not always consistent. For the purposes of this reference tool, the term 'default' refers to a failure to comply with some aspect of the PPP contract which gives the other party the right to terminate the contract prior to its scheduled expiry.

The term 'breach of contract' refers to a failure to comply with some aspect of the PPP contract, though this failure may or may not entitle the other party to terminate the contract.

A PPP contract can be very precise in specifying the events that constitute a default and can be a closed, itemised list of events or an open-ended list with (e.g. a catch-all provision for any material breach). More generic default definitions can be more difficult to implement as they require extensive legal interpretation. What constitutes a default may also be governed by the applicable underlying law in addition to, or instead of, the PPP contract.

Project Company defaults may include performance breaches, breach of applicable safety or environmental standards, breach of insurance obligations, cross-breaches under the loan agreements with the Project Company's lenders (a breach of a term of a loan agreement that triggers a corresponding breach under the PPP contract) or insolvency of the Project Company. Insolvency is detailed in Chapter 6 (Insolvency).

A default will not typically lead to automatic termination. Instead, a default will give the party that is not in breach of the contract a right to terminate, which it may choose to exercise. In several jurisdictions, court intervention is required to make a termination effective.

Termination procedures can include escalation provisions in respect of less serious breaches of contract:

- Persistent minor breaches of contract may lead to a default
- The accumulation of payment deductions above a certain threshold may trigger a default
- The Project Company not completing construction by a certain final extended date for delivery of project that will trigger a Project

Company default (notwithstanding the construction was already delayed) (long stop date)

Procuring Authority defaults can include a failure to make a payment when due, or a failure to comply with some other obligation, such as providing access to land. There are several other examples of breaches and defaults which will depend on the type of project asset and the structure of the PPP.

As detailed in Section 7.2 (Guidance) many defaults will also entitle the party in default to a chance to remedy default before termination is available.

PPP contracts often also provide a list of specific events or causes, known as 'relief events' for which the Project Company is protected against default if these events, outside of the party's control, cause it to fail to be able to perform. For example, a *force majeure* event is typically included as a relief event.

A right to terminate will typically exist however if a *force majeure* event (or another 'relief event') continues for a prolonged period. What constitutes a prolonged period may be set out in the PPP contract. Often both the Procuring Authority and the Project Company will have a right to terminate the PPP contract after a prolonged *force majeure* event.

It is also common for PPP contracts to include a provision for the Procuring Authority to terminate the contract voluntarily, or for the right to voluntarily terminate to be qualified by a 'public interest' test. Similar principles may be addressed in a country's underlying legal system. In either scenario, the practical application of the termination will depend on the PPP contract and/or the underlying legal framework. The financial implications of voluntarily terminating the PPP contract are likely to be similar to the implications of a Procuring Authority default and so will be very costly for the Procuring Authority.

Termination compensation

When a PPP contract is terminated, compensation may be payable by the Procuring Authority to the Project Company, even where the termination was the result of a Project Company default.

Terminations due to a Procuring Authority default or voluntary termination by the Procuring Authority are typically not favourable for the Procuring Authority, as the financial consequences are substantially worse than in the case of termination due to a Project Company default. Compensation will be based on the principle that the Procuring Authority should not unjustly benefit from the

termination when the termination has occurred due to the Procuring Authority failing to comply with its contractual obligations (e.g. by failing to provide the required land access).

This is justified by the fact that the project assets are transferred back to the Procuring Authority upon termination, and the principle that the Procuring Authority should not unjustly benefit from receiving an asset early, given that the private partners will have contributed capital towards the asset. In the case of termination due to the Project Company's breach of contract, the Project Company's equity investors will typically receive no compensation. Some compensation is, however, typically available to the Project Company's lenders where an asset is being handed back to the government.

Several methods can be used to determine the compensation payment, as set out in the *EPEC Guide on PPP Terminations*¹ and the 2017 version of the *World Bank Guidance on PPP Contractual Provisions*.²

This compensation may be provided for in the PPP contract, under the applicable laws or other agreement. In some jurisdictions, the courts will need to intervene to decide on the level of compensation payable.

7.2 Guidance

The following guidance outlines the key issues that should be considered when managing defaults and termination in relation to a PPP contract.

A. Be aware of the rights of both parties and any agreed pre-termination procedures in the PPP contract and under the applicable laws

The rights of both parties to terminate the PPP contract need to be well understood by the Procuring Authority. Some examples of defaults are detailed in Section 7.1 (Background); ultimately, however, the Procuring Authority should be aware of the specific termination regime set out in the PPP contract or under the applicable laws so that it can adequately mitigate the risk of project termination.

Termination provisions typically include additional safeguards against termination, such as 'relief events', default cure procedures and other practical procedures (such as periodic reporting and the right for the Procuring Authority to increase monitoring in certain circumstances). These safeguards should be well understood and utilised.

It is typical to allow the defaulting party a chance to remedy breaches of the PPP contract which are capable of being remedied. Some defaults may not be capable of remedy and so will lead to an immediate right to terminate the PPP contract (e.g. insolvency of the Project Company).

For other breaches, the parties will generally be given an opportunity to rectify a default and continue performance under the PPP contract. For example, in the case of a default, a Project Company may be required to submit a remediation plan for the Procuring Authority to review and approve.

Where a remediation plan is required the focus should be on returning to a scenario where the project is providing the service and value for money forecast at financial close. The parties should consult on relevant issues, such as the likely duration of the default and the action to be taken to mitigate its impact. The Procuring Authority should be clear about its requirements and monitor the implementation of the remediation plan, which is typically done in conjunction with a third-party expert.

If the Procuring Authority is not reasonably satisfied that the steps taken to remedy the default as agreed in the remediation plan are adequate, the default will typically lead to a Procuring Authority termination right. Therefore, this process must be followed with the appropriate gravity. Step-by-step

¹ Available at <http://www.eib.org/epec/g2g/iv-project-implementation/41/416/index.htm>.

² Available at <https://ppp.worldbank.org/public-private-partnership/library/guidance-on-ppp-contractual-provisions-2017-edition/>.

plans and procedures should be agreed to allow for independent and concurrent verification of the phased implementation of remedial measures, which may be large and complex. Any remedial plans will also be scrutinised by the lenders, as termination of the PPP contract has the potential to impact the lenders substantially.

There is no long-term benefit in the Procuring Authority unreasonably penalising the Project Company or frustrating its ability to remedy the breach and continue performance of the PPP contract. In addition, such frustration may increase the risk of claims being made against the Procuring Authority. Claims are detailed in Section 3.5 (Claims).

B. Monitor potential Project Company defaults to manage termination risk at an early stage

The first step in managing the risk of Project Company default is for the Procuring Authority to be sufficiently aware of – and to monitor the Project Company for – potential defaults. The Procuring Authority should also monitor its own potential defaults; that topic is detailed below under guidance H. ‘Monitor and ensure compliance with the Procuring Authority’s obligations under the PPP contract and under the applicable laws’.

Such monitoring can include reviewing performance and financial reports, site inspections, notice requirements for potential defaults and other early indicators. In all of these examples the Procuring Authority can receive early warning of potential defaults. A good understanding of the PPP contract and the underlying legal system will help the Procuring Authority to be well aware of the potential implications of any such early warnings. Guidance on performance monitoring is detailed in Section 3.2 (Performance monitoring) and guidance on monitoring financial performance is detailed in Chapter 6 (Insolvency).

The Procuring Authority should not be caught unaware by a Project Company default as long as it appropriately monitors the performance and financial indicators of the Project Company. The Procuring Authority should carry out continual assessments of the likelihood of termination throughout the project. Following the relevant procedures will generally ensure advance warning is received by the Procuring Authority before a default occurs.

C. Consider termination and the full financial and non-financial implications of termination

Once the relevant termination procedures have been followed under the PPP contract or under the legal framework, if a remedial action is not possible or was not followed by the Project Company, the Procuring Authority may then have the right to terminate the PPP contract. This will require the Procuring Authority to provide a termination notice. Such a step is not a minor decision and the government should ensure it has considered the full implications of issuing the termination notice. A decision to issue a termination notice should only be taken after consideration of the financial and non-financial consequences of such an action.

There are several key issues that should be considered:

- The circumstances in which the PPP contract may be terminated ahead of its scheduled expiry
- The compensation payment (if any) that must be made upon termination (either by the Procuring Authority to the Project Company or vice versa)
- The condition of the project when it is ‘handed back’ following termination, detailed in Section 3.1 (Transitions)
- How to ensure service delivery remains uninterrupted during the termination process (detailed further below in this section)
- The reputational impacts of terminating a PPP contract, including the broader market implications, particularly where equity investors, lenders or contractors are adversely affected

Common termination compensation principles are detailed in Section 7.1 (Background).

The compensation calculation may be complex to implement and the Procuring Authority should engage legal and financial advisors for this process. Because the two parties to the PPP contract have conflicting interests in the calculation of termination compensation, there is the potential for disputes to arise.

The Procuring Authority needs to carefully ensure that no unjust enrichment or other claim can be made against it where the project assets have been handed back and the Procuring Authority has not paid adequate compensation.

In a case of potential termination, the Procuring Authority may be required to go to the ministry of finance or central government to request

funds to finance a termination compensation payment (particularly in a scenario where it is not retendering the project). A termination shortly after completion of construction is likely to involve higher compensation amounts, because the Project Company's debt liabilities are typically the highest at this time. The bidders may have also required a government guarantee in order to enter into the PPP contract. In light of these challenges, the Procuring Authority should work with other relevant government agencies at an early stage to ensure there will be funds available to pay any termination compensation. Stakeholder engagement with other government agencies is detailed in Section 3.3 (Stakeholder management).

From a legal perspective, the Procuring Authority should be aware that when a Project Company default arises it may have to use the right to terminate or lose it. For example, in several common law jurisdictions, a right to terminate may have to be exercised or be lost; it cannot be held over the Project Company in perpetuity. The more time that elapses after a default arises, the more likely it is that a court will consider that the Procuring Authority has elected to continue with the contract.

EXAMPLE

Project Company difficulties in obtaining finance

The Project Company in one of the case studies in Brazil is facing financial difficulties with lower than expected toll revenue, and challenges in raising the required debt finance. The Procuring Authority is considering extending the period in which investment can be completed, as well as whether to take alternative steps such as:

- Terminating the PPP contract and retendering the project
- Replacing the equity investors with new equity investors capable of raising the required debt finance
- Requiring the existing equity investors to commit additional equity.

For more information, see the Brazil Toll Road Case Study.

D. Seek legal advice before issuing a termination notice

Given the complexities of PPP contracts and termination regimes, and the potential implications related to a termination, the Procuring Authority should seek legal advice confirming that it does have the right to terminate the PPP contract. Any termination compensation payable to the Project Company may also depend on whether the Procuring Authority has properly terminated the PPP contract.

Although examples of some of the procedures the Procuring Authority may need to follow from an operational point of view are set out in this section, the detailed requirements will be specific to a given PPP contract and the underlying legal framework and will need to be followed diligently.

Once a termination notice is issued by the Procuring Authority, it may not be capable of being recalled. In such circumstances - if it is found that the Procuring Authority did not have a valid right of termination - the PPP contract cannot be resurrected. Rather, there would be a potential claim against the Procuring Authority for unjust termination of the contract, and a starting point for termination compensation would be at a much higher level.

In several jurisdictions a termination notice must be preceded by a court proceeding, thus assuring the right of the Project Company to defend the termination. Given the complexities around PPP contracts and termination regimes and the potential implications of getting it wrong, it may still be advisable for the Procuring Authority to first seek a formal declaration that it has the right to terminate even in jurisdictions where a court proceeding is not strictly required.

There are additional restrictions in some jurisdictions which mean that a PPP contract cannot be terminated until the Procuring Authority takes over the project or a new Project Company is awarded a contract to take over the project. This stems from principles of continuity and adaptability of public services, under which public services must be guaranteed by the Procuring Authority and must not be threatened by action or inaction of the relevant private partner.

EXAMPLE**Inability to meet specifications**

A specific case of default can occur where the Project Company has not been able to meet the specifications agreed in the PPP contract. This is important for projects where there is the use of a new technology which is vital to service provision but the performance of which is not yet fully known (e.g. a waste sorting facility on a waste project). Certain waste projects are encountering this challenge and there is a possibility that the Project Company will simply not be able to provide the service it is required to.

For example, if the winning bidder has 'oversold' its solution and created a specification that no one could obtain with current technology, then from a legal perspective, an impossibility to meet project specifications creates a difficult legal position. Existing standard form PPP contracts are not designed to address such a situation.

E. When terminating a PPP contract, plan early to ensure service provision is uninterrupted

A termination should be properly planned before the termination notice is delivered. Once the Procuring Authority has followed the required processes and obtained appropriate legal advice, the Procuring Authority needs to ensure that the implications of issuing the termination notice are clearly understood and the continuity of service for the users will be ensured, including engaging appropriate support to manage the process. Terminating a PPP contract has the potential to interrupt services and for the Procuring Authority to incur significant costs.

The Procuring Authority will have two options in case of a termination. The appropriate option should be decided well before the termination of the PPP contract such that the Procuring Authority can plan the transition and avoid the risk of suffering disruption or interruption in service delivery.

1. Retendering

The Procuring Authority is entitled to retender the project to a new Project Company, provided there is market appetite. The amount received from the winning bidder in the retendering may be applied towards paying termination compensation to the original Project Company.

The Procuring Authority will have to comply with the relevant procurement laws in that jurisdiction.

2. No retendering

Where the Procuring Authority decides not to retender the project and to take over the asset itself, it will typically still be required to appoint contractors to deliver the services required under the original PPP contract. The short term financial implication of this option will be more severe for the Procuring Authority as it will not receive an amount from the new Project Company.

The method of transferring the project assets, and whether to transfer them straight to the winning bidder (without being handed back to the Procuring Authority), should also be addressed at an early stage and there may be specific procedures required by the underlying legal system.

EXAMPLE**Cross-border rail termination**

The PPP contract on a cross-border high speed rail project was terminated by the two national Procuring Authorities after the insolvency of the Project Company. A new operator was set up as a joint venture between the two national governments to continue the provision of the rail services.

F. Where a substitute Project Company is required, consider all potential effects of the substitution

Where the PPP contract is terminated and retendered, the choice of the substitute Project Company will require the Procuring Authority's approval.

The Procuring Authority must determine that the new Project Company is eligible, including that it complies with the PPP contract, any direct agreement, the applicable laws, regulations and standards; and that it has the requisite track record and reputation, technical expertise and financial resources. For example, the relevant procurement regulations that covered the procurement process prior to financial close may become relevant again, including being subject to retendering requirements.

A range of contingent liabilities will also typically exist for the Procuring Authority depending on what support and guarantee mechanisms are in place,

such as any government guarantees of payment obligations and the agreed risk allocation. These contingent liabilities must be considered, as they may be affected by the structure of the new Project Company (including the new Project Company's debt financing arrangements).

The Procuring Authority may also need to negotiate the duration of any services suspension while a transfer is taking place, the extent of a 'temporary amnesty' or 'wipe clean' mechanism related to any existing payment deductions to be given to the substitute Project Company, criteria for the replacement of any contractors, and a detailed remedial plan for resolving the overall issues.

G. Consider the Project Company's lenders including their potential step-in right

If termination becomes a real possibility, the Procuring Authority should communicate with lenders at an early stage, while being careful to comply with all applicable laws. For example, giving preferential treatment to a particular lender or class of creditors may breach insolvency laws.

Given the seriousness of a default and potential termination, lenders will closely monitor any event of default. This is broadly positive for the Procuring Authority, as the lenders are incentivised to intervene and help the project achieve its goals. Both the lenders and the Procuring Authority have strong drivers and incentives to want the service provided to the end-user to not deteriorate.

The research highlighted that sometimes the relationship between the Procuring Authority and the lenders was sometimes almost non-existent at the earlier stages of Project Company breaches of contract. The Procuring Authority may therefore not have much visibility of the lenders' involvement and actions at these stages.

In addition, it is common for the lenders to want a chance to step in to cure a Project Company breach of contract, as detailed in Chapter 6 (Insolvency). In these circumstances, there is typically a direct agreement entered into between the Procuring Authority, the Project Company and the lenders. Under this arrangement, the Procuring Authority will need to permit the lenders to take control of the PPP project under the step-in provisions, give the lenders a chance to remedy the breach, and not terminate the PPP contract until the lenders have had the chance to exercise their step-in rights. The direct agreement will typically set out a timeframe during which the lenders will have to cure the contract

breach and the Procuring Authority may be required to go through an additional round of remediation plans with the lenders.

Lender step-in is quite rare in practice because of the lenders' reluctance to take over the role of the Project Company and the complexities associated with the execution of these provisions. In Brazil, lenders are not entitled to step-in to the project to take control without a prior authorisation by the Procuring Authority. In the study no examples of lender step-in were encountered.

H. Consider step-in rights of the Procuring Authority

The Procuring Authority will typically have the right to step in and take action in order to undertake certain activities of the Project Company when the Project Company is failing to meet its obligations under the PPP contract. The reasons for step-in may be defined and are typically based on protecting the public interest. Procuring Authority step-in is not a common event. In the study only one clear example of Procuring Authority step-in was encountered, where an environmental incident occurred and the Procuring Authority stepped in to address the situation.

The Procuring Authority may have the right to step in to address a breach of contract before it becomes a Project Company default. This may affect any right to terminate the PPP contract that the Procuring Authority would otherwise have had.

The Procuring Authority should step in when it believes it needs to take action that requires an urgent response, such as where there is a serious risk to the health and safety of persons, property, or to the environment. It may also be required to step in to discharge a statutory duty. A Procuring Authority may decide to step in in situations where the Project Company has failed to meet its obligations. However, step-in can also occur where the Project Company is not in breach, but there is some other justifiable reason.

While step-in is clearly justified for certain events (e.g. where there is an overriding public service or national interest issue) there is an argument that for less serious issues the Procuring Authority should not have the right to step-in; it should apply the payment deductions and ultimately terminate for default if it is not satisfied with performance.

Where the Procuring Authority does decide to step in, it should ensure it provides sufficient notice of its step-in, as well as its step-out, should it decide that

its actions are no longer required. As the Procuring Authority will be taking over responsibility of certain functions, it must be aware of the capacity and expertise that will be required by these activities.

In some jurisdictions the approach is that even where a step-in is motivated by a Project Company default, the Project Company should be adequately compensated in terms of its payment, save only for the costs incurred in stepping in and rectifying the issue in question. The logic in this is that, if the Procuring Authority can both step in and apply payment deductions for non-performance, the Project Company is no longer in control of its own destiny and is at the mercy of the Procuring Authority acting swiftly and reasonably.

I. Monitor and ensure compliance with the Procuring Authority's obligations under the PPP contract and the applicable laws

It is important for the Procuring Authority to ensure that it carefully manages any potential default of its own causing, and does not find itself in a situation where it could be assessed to have committed a default in any way. Termination due to a Procuring Authority default, due to the actions of another government agency or due to the Procuring Authority's voluntary election to terminate in the absence of default, are typically the most costly to the Procuring Authority.

The Procuring Authority must monitor and assess the situation as soon as it becomes aware of any potential default which would trigger a termination right for the Project Company. The Procuring Authority obligations under a PPP contract (with which failure to comply may lead to a default) are principally payment obligations and approval rights, rather than detailed performance obligations. However, in some instances where the Procuring Authority retains land acquisition or permitting risk, any failure to fulfil these obligations is likely to render the Project Company unable to meet its obligations and may subsequently lead to a default. The Procuring Authority may also have positive obligations to complete interfacing infrastructure.

The occurrence of a Procuring Authority default, whether notified by the Project Company or not, must trigger an alarm at the highest levels of the Procuring Authority together with immediate action to avoid termination. The Procuring Authority contract management team needs to be well aware of the agreed defaults (whether provided for in the PPP contract, under the applicable laws, or another agreement) such that it can act before the Project

Company serves the Procuring Authority with a termination notice.

Once the Project Company has served a default notice, the Procuring Authority will typically be given a cure period (that is, time in which to rectify the default, where possible) before contract termination can occur. This gives the Procuring Authority a final chance to avoid termination and its associated consequences.

All effort and resources should be applied to carry out whatever mitigation is required, although that mitigation should have started well before notice was served by the Project Company.

Another approach when a Procuring Authority default is inevitable is to work with the Project Company to make the arrangement work through a renegotiation process. Specific guidance on renegotiation is detailed in Chapter 4 (Renegotiation).

EXAMPLE **Interfacing works**

At the time of signing the PPP contract for the Intercity Express Programme project in the UK, the parties agreed that the Procuring Authority should retain the risk for delays caused by delays in Network Rail delivering interfacing works. Network Rail was classified as an arm's length public body in 2014 and is a separate body to the Procuring Authority. Delay and cost caused by Network Rail's delay in delivering interfacing electrification works did cause delay and cost to the Project Company. This demonstrates the impact third parties can have on an overall program of works.

For more information, see the Intercity Express Programme Case Study.

EXAMPLE**Renegotiation**

The lenders on the Segarra Garrigues Irrigation System project in Spain exercised their rights to stop providing debt to the Project Company when the credit rating of the Procuring Authority dropped below a defined level. This default caused delays to the project and forced the regional government to renegotiate the financing for the project as well as the PPP contract.

For more information, see the Segarra Garrigues Irrigation System Case Study.

J. Monitor the performance of key contractors, whose termination can present a significant risk to a project

A default with respect to a key contractor under a relevant subcontract (such as a construction contractor default under a construction contract) can present a significant risk to the Procuring Authority. For example, it may lead to a Project Company default under the PPP contract. It is important for the Procuring Authority to monitor these risks, particularly during construction. Termination of a construction contract during construction significantly increases the risk of a project.

The Procuring Authority should identify the risk of potential key contractor default as early as possible and monitor how the risk evolves. The risk register should provide a continuous assessment of the termination risk in terms of its likelihood, severity and potential mitigation measures. For example, the Procuring Authority can monitor the construction contractor's publicly available financial indicators.

The Project Company will typically require key contractors to provide a security package (that is, performance guarantees and/or appropriate agreed compensation, etc.) to mitigate the implications of the termination of a key contract.

The PPP contract may stipulate, in the case of termination of a key contract, that the replacement contractor will be required to be reputable and financially robust, have the requisite resources and experience to complete the works, and willing to agree to a construction contract on similar terms to the original key contract. These attributes will be important to the Procuring Authority to minimise the risk of poor performance by the key contractor.

The Project Company will seek to replace the key contractor as soon as possible to reduce the risk of a default event under the PPP contract, and to minimise any financial implications. This could lead to a choice of replacement contractor that does not meet the requirements of the Procuring Authority, and this process should therefore be managed closely by the Procuring Authority. Working with the Project Company to agree to the appointment of a new contractor will typically be in the best interests of the project and the Procuring Authority.

The ease of replacing a contractor will depend on a number of factors, including:

- The complexity of the construction or operations – for large, complex projects it will be harder to find a suitable replacement
- The market in which the key contractor is required to operate and how many equivalent contractors in that market have capacity
- The stage during which the insolvency has occurred: During the early stages of the construction phase, it may be easier to find a replacement; Conversely, during the operations phase, it may be easier to find a replacement if operations have already been running for a period of time

If the relevant contract has been signed by a joint venture of contractors, tied under joint and several liability, then the other member(s) of the joint venture will take over the obligations of the insolvent contractor. This may make the situation easier, and there is the potential for this problem to be resolved with little input from the Procuring Authority.

EXAMPLE**Construction long stop dates**

It is common that a failure by the construction contractor to meet a long-stop date agreed in the construction contract between the Project Company and the construction contractor will constitute a construction contractor default under the construction contract and entitle the Project Company to terminate that construction contract. The long-stop date signifies the final date that the construction contractor can complete the construction works before a default occurs. The Project Company will aim to ensure a construction contract default will not immediately trigger a Project Company default under the PPP contract and will have a corresponding longer long-stop date under the PPP contract to provide time for the Project Company to replace the original construction contractor and complete the construction works before a Project Company default occurs.

Although the long-stop dates may be staggered in this way, the buffer periods may not be long enough to allow the Project Company to terminate and appoint a new contractor and complete the works before the Project Company default occurs. Instead, the buffer period provides useful breathing space for the Procuring Authority to open up dialogue with the Project Company to decide the approach to be taken that will be in the best interests of the project. Note, such discussions will require legal advice, particularly where termination rights are being waived.

EXAMPLE**Insolvent construction contractor**

One of the members of the construction joint venture on a project in Europe became insolvent. The remaining members of the joint venture took over the work, which the Procuring Authority monitored carefully.

7.3 Summary data analysis

This section provides a summary of the data analysis related to defaults and termination. The full data analysis is available in Appendix A (Data Analysis).

Early termination is not a common occurrence for PPPs. In the research, there were 13 examples of projects which were terminated for various reasons. There was only a single example where the Project Company terminated the PPP contract alone (the Alupar Small Hydro Plant project in Brazil). On two occasions both parties claim to have terminated the PPP contract: in the Manta Port project in Ecuador; and in the ABG Kandla Terminal project in India. In both cases the Procuring Authority argued that the Project Company had failed to invest in the works in which it was required to invest.

Where the Procuring Authority terminated the PPP contract, it was generally before the project was operational and after deciding that the project was not worth continuing. In the Prato-Signa Link project in Italy and the Vengalem Kuttipuram Highway project in India, termination occurred before construction had commenced (very early in the project) after delays to the start of construction. In the case of the Aqaba Port project in Jordan it was decided to expand existing facilities rather than build a new facility. For the Sao Paulo Metro Line project in Brazil the contract was terminated due to a failure by the Project Company to deliver construction on time and a new contract with another Project Company was signed soon after. The Active Perovo Solar Plant project in Crimea, Ukraine, was terminated after the area was annexed by Russia.