CHAPTER 3

Routine Contract Management

Contents

3 Construction and operations routine contract management

Routine contract management involves tasks that either occur on a regular basis or are expected to occur at least once over the life of a contract. It includes ongoing tasks, such as performance monitoring and the management of relationships with the Project Company or stakeholders, as well as discrete events such as managing the transitions between different phases of project development.

The topics covered in this chapter are:

- Transitions (Section 3.1)
- Performance monitoring (Section 3.2)
- Stakeholder management (Section 3.3)
- Information management (Section 3.4)
- Claims (Section 3.5)
- Change of ownership (Section 3.6)
- Refinancing (Section 3.7)

3.1 Managing transitions

All PPP projects experience transitions between different phases of the project (i.e. from financial close to construction, from construction to operations, and from operations to handback). This is displayed in Figure 1. Each of these transitions represents a period of substantial change, typically involving turnover of staff within both the Procuring Authority and the Project Company, as well as new responsibilities and challenges.

Each transition typically includes a period of mobilisation which requires extra cooperation between the Project Company and Procuring Authority. For example, some joint training and inductions may be required at the start of operations and service commencement. In addition, there are often specific requirements that must be met during transition, and before a new phase can officially start. For example, conditions related to construction commencement or handback requirements, which are required to be met before the project is handed back to the government.

If handled inadequately, issues that arise during a transition period can continue to cause problems throughout the life of the project, leading to additional costs for the Procuring Authority or negatively affecting the level of service provided. This section 3.1 provides guidance on how to successfully manage transition periods and minimise any negative impacts on the project.

The guidance is split into three distinct transition periods related to the development of the project itself, and a fourth related to external factors:

- Financial close to construction (Subsection 3.1.1)
- Construction to operations (Subsection 3.1.2)
- Operations to handback (Subsection 3.1.3)
- Change in government administration or government policy (Subsection 3.1.4)

Figure 1: PPP project life cycle for a typical greenfield project, showing transitions between phases

3.1.1 Financial close to construction

Financial close refers to the point at the end of the procurement phase where the PPP contract has been signed, any conditions precedent for financing are met and financing is in place so that the Project Company can commence construction. This subsection 3.1.1 provides guidance on the transition to construction for both greenfield and brownfield projects, acknowledging that on some brownfield projects, the construction and operations periods may start concurrently.

Because the transition to construction occurs at the beginning of the project, it has potential to substantially influence the long-term success of the project, either positively or negatively. The Procuring Authority should plan for the transition thoroughly to ensure that the construction phase has a strong and uninterrupted start. A well managed transition can also highlight any weaknesses in the contract drafting, enabling them to be rectified at the operational level before they escalate into disagreements, which can lead to, delays and disputes.

EXAMPLE

Transition planning

The Project Company on the Qiaoxi District Central Heating project in China was required under the PPP contract to provide heating services no later than the date of commencement (allowing one third of the usual days needed). By arranging for the storage of additional fuel, and by a number of the Project Company's equity investor's experienced maintenance employees providing assistance in advance, the Project Company was able to carry out the transition without interruption to the services.

For more information, see the Qiaoxi District Central Heating Case Study.

SUBSECTION STRUCTURE

This subsection provides guidance on managing the transition from financial close to construction. The key elements of successfully managing the transition are summarised below and detailed in this subsection under the heading 'Guidance':

A. Focus on setting up an effective contract management team

B. Ensure adequate resourcing is employed for sign off on design and other documentation

C. Work closely with the Project Company with respect to any delays in land acquisition

D. Ensure good resettlement practices are adopted where land acquisition affects local communities

E. Collaborate with the Project Company where appropriate to ensure permitting issues are resolved efficiently

F. Engage with other relevant government agencies early to ensure potential delays are mitigated

In addition, the Attachment (Financial close to construction checklist) to this subsection sets out a template checklist that can be followed by a Procuring Authority when managing a transition from financial close to construction.

GUIDANCE

A. Focus on setting up an effective contract management team

The transition from financial close to the start of construction marks the stage by which the Procuring Authority's project specific contract management team needs to be set up and trained. As detailed in Chapter 2 (Contract management team set-up and training), this is a key task which should be carefully planned and reviewed, as the skillset required post financial close is fundamentally different from the transactional expertise needed to reach financial close.

It is recommended that procurement and contract management staff overlap to some extent before and after financial close, to allow sufficient time for training and knowledge sharing. It is also important that both the Project Company and the contractor (and possibly key subcontractors) are required to maintain overlapping staff from procurement to construction.

The research indicates that Procuring Authorities often change their contract management team completely following financial close. Where this is the case, a carefully managed and comprehensive handover is vital.

Hiring staff can also be a lengthy process, and the process may take even longer in less developed markets where there may not be as many people available with relevant experience.

EXAMPLE

Training during the transition from financial close to construction

To assist with knowledge transfer on the Barranquilla Airport project in Colombia, workshops were carried out with new staff joining after contract award by representatives from ANI's (Colombia's National Infrastructure Agency) central knowledge teams, and the ANI team and consultants that structured the contract. The external consultants involved in the structuring, also worked hand-in-hand with the Procuring Authority for six months after contract signing and provide continued support, as and when necessary.

For more information, see the Barranquilla Airport Case Study.

B. Ensure adequate resourcing is employed for sign off on design and other documentation

The Procuring Authority needs to understand and prepare its team for the volume of data and documentation that it will be required to review and sign off during the transition from financial close to construction. It is common for the Procuring Authority to require oversight of detailed design and the quality of materials, and therefore it needs the team and processes in place to support this oversight and to ensure that it can respond within the timelines set in the PPP contract. PPP projects can involve greater discretion for the Project Company to design the project than what would typically be seen in a traditional design and construct contract. This will mean that the design sign-off procedures will be more complex than what they would be if the Procuring Authority had contracted directly with the construction contractor. This additional complexity should be taken into account to ensure that the Procuring Authority complies with its approval obligations in the time required in the PPP contract.

C. Work closely with the Project Company with respect to any delays in land acquisition

Land acquisition refers to the act of acquiring title in the land required for infrastructure delivery. In addition to requirements of land acquisition, there can be a need to establish right of way without having to purchase land. Relocation and diversion of utilities may also be required before the construction can begin, which will raise similar issues.

Procuring Authorities should work closely with Project Companies with respect to any delays in land acquistion during this transition phase. Availability of land is integral to the construction schedule, so where land is not available at the time it was contemplated, it will likely cause delays.

There is often political pressure to achieve financial close on a project before all the required land acquisitions have been completed, in order for it to be seen to have started. One way of managing this is through appropriate use of early works agreements to enable some work to begin before financial close.

Where financial close is achieved before all required land acquisitions have occurred, the Procuring Authority should keep the Project Company informed of the acquisition progress so that any delays can be managed from a very early stage by both parties, including agreeing to changes in the construction schedule and compensation where appropriate. Claims are detailed in Section 3.5 (Claims).

Land acquisition is particularly challenging for linear projects with extensive land requirements, such as road and rail projects and transmission lines. Densely populated areas also make land acquisition a difficult issue in most regions. Expropriation of land may involve lengthy negotiations with existing landowners, court proceedings and the need for a detailed resettlement strategy – a process which generally takes longer than anticipated. In some jurisdictions land ownership is very fragmented, making land acquisition more challenging.

Different aspects of land acquisition may also require specific third-party agreements with stakeholders, such as shop owners and utility owners affected by the construction activities or the new infrastructure, which should be managed in a well-planned and consistent manner.

EXAMPLE

Delays caused by land acquisition delays

The Gautrain Rapid Rail Link project in South Africa highlights the complexities and consequent delays that can arise due to land acquisition. In that project, pressure to meet the FIFA World Cup deadline meant that work on land acquisition was not completed before construction. It noted that challenges are not only due to non-supportive land owners, but relevant stakeholders will often have concerns over other issues such as environmental impact.

For more information, see the Gautrain Rapid Rail Link Case Study.

D. Ensure good resettlement practices are adopted where land acquisition affects local communities

Acquiring land or right of way may involve resettlement of local populations and compensation for lost economic uses such as agriculture and other economic and social benefits. Poor resettlement practices have the potential to lead to adverse social outcomes (such as protests) and reputational damage and so need to be managed carefully by the Procuring Authority (irrespective of which party is responsible for the risk of resettlement). Court proceedings, as they relate to poor practices in resettlement, also have the potential to affect access to land.

Resettlement action plans typically require Procuring Authorities to meet both national and lender requirements (such as development bank safeguard requirements). This is a complex topic and the reference tool does not attempt to address the issue in detail.

E. Collaborate with the Project Company where appropriate to ensure permitting issues are resolved efficiently

The Procuring Authority can play an important role in ensuring timely agreement on environmental and other permits required. These permits are generally issued by regulatory stakeholders, with whom the Procuring Authority may have ongoing relationships.

In some urban areas, and in environmentally sensitive areas, the number of permits to be secured for construction works and the associated burden can be high. Therefore it may be appropriate that the parties work together in a coordinated fashion in order to secure approvals and permits in a timely manner.

EXAMPLE

Environmental permits

The responsibility for acquiring permits in Brazil typically rests with the Project Company, as was the case in the 500kV Tucuruí-Jurupari Transmission Line project in Brazil. Delays in obtaining construction permits in Brazil have previously led to delays in starting construction, and a reduction of the operational period. Contract drafting has evolved in Brazil such that new PPP contracts now define the environmental permitting as a shared risk and allow more time for permitting.

For more information, see the 500kV Tucuruí-Jurupari Transmission Line Case Study.

EXAMPLE

Construction permits

One issue that occurred during construction of the Brabo 1 Light Rail project in Belgium was a situation in which the Project Company's construction permit was revoked because of public objections to the proposed developments. A new permit was, however, issued a few months later. Together with the Project Company, the Procuring Authority worked as a partner to resolve the issue.

For more information, see the Brabo 1 Light Rail Case Study.

F. Engage with other relevant government agencies early to ensure potential delays are mitigated

Where local authorities have a degree of separation from other relevant government bodies, it is essential that they are involved as early as possible. In some jurisdictions, local authorities can impose taxes on particular projects or can delay projects procured by the national or state government by not issuing, withholding or revoking relevant permits required for construction works. It is important that these stakeholders are involved pre-financial close to make sure any additional requirements are adequately addressed.

For example, in India land management is under the jurisdiction of individual states and a dedicated authority for land acquisition, over which the relevant Procuring Authority often has no control. The National Highways Authority of India has experienced major delays on some highways PPPs as a result of delayed land acquisition. As a result, the Procuring Authority typically enters into state support agreements with the relevant states upfront to facilitate efficient land acquisition. Stakeholder engagement with respect to other government stakeholders is detailed in Section 3.3 (Stakeholder management).

ATTACHMENT: Financial close to construction checklist

The template checklist below can be used by a Procuring Authority when approaching the transition phase between financial close and construction.

- Recognise that the PPP contract documentation is voluminous and complex and not to be used as the sole operational tool.
- Create a clear understanding in the contract management team of what the PPP contract caters for and incorporate key contract terms into a user-friendly contract manual.
- Clearly define all roles related to preparing/updating and maintaining the project specific contract management manual, bearing in mind that this manual is not a substitute for the PPP contract but is a tool to be used to better navigate the PPP contract.
- Carry out engagement with key stakeholders (e.g. local authorities, regulators, utility providers and any other third parties) whose approvals, agreement or permits may be required to enable the commencement of construction works.
- Engage end users and other affected parties throughout the process.
- Address land acquisition and access issues as early as possible and be aware of both government and lender requirements (e.g. multilateral development banks) on resettlement action plans and compensation.
- Maintain clear records and data management procedures in relation to resettlement actions and compensation to ensure transparency and to address subsequent disagreements.
- Keep the contract management manual up to date with an 'operational diary' and procedural matters for the Procuring Authority.
- Share relevant parts of the contract management manual with the Project Company to foster coordination.
- Test the Project Company's performance management tools in advance of PPP contract commencement to ensure they are functional and compliant with the Procuring Authority's systems.

3.1.2 Construction to operations

The transition from construction to operations covers the period when the infrastructure has been built and is ready to commence operations. An additional element of this phase is sometimes referred to as the 'bedding-in' phase, where full payment deductions ordinarily available to the Procuring Authority may be discounted for several months to allow the Project Company to settle in to the operations phase without being penalised.

This phase can be a time of increased tension between the Procuring Authority and the Project Company because of the contractual milestones and payments involved, as well as a change of contractors.

SUBSECTION STRUCTURE

This subsection provides guidance on managing the transition from construction to operations. The key elements of successfully managing the transition are summarised below and detailed in this subsection under the heading 'Guidance':

A. Ensure adequate resourcing is employed for testing and commissioning

B. Plan for testing and commissioning early, and consider establishing a testing and commissioning panel

C. Allow adequate time for the parties to become familiar with the operational Key Performance Indicators and payment mechanisms

D. Focus on the relationship with the Project Company during the transition between construction and operations, and mitigate the risk of disputes

GUIDANCE

A. Ensure adequate resourcing is employed for to testing and commissioning

Testing and commissioning is a distinct activity marking the transition from construction to service operation. As construction works come to an end, as part of its mobilisation for the operations phase, the Project Company must meet specific contract requirements in order to demonstrate the project's readiness for operations. The Procuring Authority is required, as part of the contract, to monitor whether these conditions have been satisfied and provide sign off, which can be a complex and time consuming task.

Testing and commissioning activities carried out by the Project Company have to be carefully coordinated with the equivalent verification activities required by the Procuring Authority. This process may also involve a number of third parties engaged to carry out the tests, or to independently verify testing and commissioning results.

The Procuring Authority will wish to utilise the full duration of the testing and commissioning period to ensure that the quality of the asset matches its expectations and standard. However, it may also be under political pressure to reach the service commencement date within tight time constraints (e.g. the service commencement of a stadium for a sporting event). The Project Company may also be applying pressure on the Procuring Authority to sign off the works as availability of revenue is often dependent on completion of the construction works, and so late delivery will erode potential Project Company profit. Rushing testing and commissioning may lead to the parties agreeing to move forward and commence service with an 'extended' list of defects, which is effectively incomplete work that causes issues down the track.

Because of the importance of this transition stage, the number of activities that must be carried out by multiple parties, and the prolonged duration, this stage presents a significant challenge to service commencement. The strategy for testing and commissioning has a significant impact on the success of the transition. The parties involved should agree on a seamless and effective procedure eliminating unnecessary delays in operation.

The specific testing and commissioning requirements are set out in the relevant PPP contract, but typically include signing off that:

- the construction works are complete except for minor defects

- any minor defects have been agreed with the Procuring Authority
- any testing required has been carried out and passed
- both parties have agreed on the safety audit
- the performance monitoring system is ready for operation
- a service execution plan is agreed with the Procuring Authority
- a monitoring plan is agreed with the Procuring Authority
- performance failure definitions and verification methods have been validated by both parties

B. Plan for testing and commissioning early, and consider establishing a testing and commissioning panel

One issue at this transition stage is that technical experts are often not sufficiently involved in the preparation of the PPP contract in relation to testing and commissioning – leading to a potential for unrealistic requirements. In particularly complicated projects with multiple assets, there may be requirements for independent testers to respond within a matter of days against complex testing criteria, which in practice requires weeks to prove to the relevant level of sign off. This can cause unnecessary tension among stakeholders and requires the Procuring Authority to be realistic about the overall construction timeline and desired commencement dates.

EXAMPLE

Early planning for testing and commissioning

The I-495 Express Lanes project in the USA highlights the need to build adequate time into the project schedule for testing and commissioning of complex tolling and traffic management systems. For that project, it was noted that detailed planning and coordination for the road opening and commencement of tolling should begin at least one year prior to the anticipated opening date.

For more information, see the I-495 Express Lanes Case Study.

A testing and commissioning panel can be set up to manage the challenge of a smooth transition from construction to operations. This panel may consist of representatives of the Procuring Authority, the Project Company, the construction contractor and the operations contractor. It should be set up before the commencement of testing and commissioning.

EXAMPLE

Operational readiness and airport transfer team in Jordan

An example of a testing and commissioning panel is highlighted in the Queen Alia International Airport Expansion project in Jordan, where the Project Company formed an 'Operational Readiness and Airport Transfer' team two years prior to service commencement. The Procuring Authority was closely involved, and the planning paid off with a successful transition.

For more information, see the Queen Alia International Airport Expansion Case Study.

C. Allow adequate time for the parties to become familiar with the operational Key Performance Indicators and payment mechanisms

Key Performance Indicators (KPIs) either contain detailed descriptions or leave room for interpretation. Therefore, a ramp-up period can be helpful to allow parties to understand the intent of the project's KPIs and a test performance evaluation can start before official commencement of the operations phase.

The practical implementation and verification of operational KPIs, and the associated definition of performance failures and payment deductions, is a challenge at the beginning of the operations phase. The definition of performance failure can be a source of tension, given its importance to the revenue of the Project Company. This is particularly relevant if the contract drafting is not clear in terms of recording performance levels and applying payment deductions.

During this period the Procuring Authority should make sure that the Project Company's quality management and management information system, performance monitoring procedures, overall reporting mechanism, and audit trail supporting the Project Company's assessment of performance, are robust and tie in with the Procuring Authority's governance and payment processes.

The administrative staff of the Procuring Authority may not have experience in making large payments during the operations phase (particularly if they are more familiar with traditionally procured projects where there won't be a large debt service component to the payments during operations). The Procuring Authority should ensure that staff are knowledgeable on internal procedures and payment mechanisms well before the deadline for the first payment becomes due.

Guidance on KPIs and payment mechanisms is detailed in Section 3.2 (Performance monitoring).

EXAMPLE

Operations 'bedding-in' periods

Several case studies highlight the need to allow adequate time for the parties to become familiar with operational KPIs including allowing 'bedding-in' periods for both the Project Company and the Procuring Authority to establish teams, procedures and plans in the first months of operations.

For more information, see the Brabo 1 Light Rail Case Study and the Port of Miami Tunnel Case Study

D. Focus on the relationship with the Project Company during the transition between construction and operations, and mitigate the risk of disputes

Testing and commissioning issues can pose a significant risk to the relationship between parties. Stakeholder management with respect to the Project Company in detailed in Section 3.3 (Stakeholder management).

The research indicated that the Project Company and Procuring Authority sometimes retreat to an adversarial contractual position when disagreements arise during testing and commissioning. On one side, the Project Company is interested in ensuring that testing and commissioning is completed on time, as it typically triggers available payment. Agreed compensation is also typically payable to the Procuring Authority if completion of construction is delayed. On the other side, the Procuring Authority typically wishes to utilise the full duration of the period contractually available to complete testing and commissioning and to ensure that the quality of the asset matches its expectations and standards.

The skillset required during the operational phase is different from the management and oversight expertise needed during construction. There may be a need to change staff at this stage to account for the change in tasks required, although key staff need to be retained over both phases to ensure knowledge continuity. In addition, this is the period when there is a distinct team change on the Project Company side.

The changes in staff on both sides can create an opportunity for the establishment of a new relationship and different team dynamics. The time needed to rebuild the relationship with the Project Company at this stage should not be underestimated. Joint training and inductions may be valuable at the start of operations and service commencement to help build the relationship.

Notwithstanding the opportunities to build a strong relationship during this transition, several of the projects studied experienced delays in reaching the operations phase in part due to adversarial relationships that were created during the testing and commissioning stage. This implies that this period may also carry a higher risk of disputes. For example, a dispute over commissioning on one waste PPP in the study has gone to court and is threatening the viability of the project itself. This is also a time when there is an increased likelihood of the Project Company bringing forward claims for cost overruns, as this stage gives the Project Company and/or the construction contractor a clear view of the overall cost position for the construction phase. Claims are detailed in Section 3.5 (Claims) and disputes are detailed in Chapter 5 (Disputes).

EXAMPLE

Staff training

The parties on the Queen Alia International Airport Expansion project in Jordan understood the challenges of transition phases from an early stage, and careful planning started two years before the transition from construction to operations. The effective transition management, as well as early planning and training, ensured good transfer of knowledge from the construction team to the operations team and helped overall readiness for service commencement.

For more information, see the Queen Alia International Airport Expansion Case Study.

EXAMPLE

Construction to operations

Sections of the completed Segarra Garrigues Irrigation System project in Spain began operations while construction was ongoing in other sections, so there has been a crossover period of many years. This is a challenge for the Procuring Authority, who has to manage both the construction and operation phases simultaneously.

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

3.1.3 Operations to handback

The operations to handback transition covers the period where the original PPP contract is coming to an end. This generally involves the asset or the operation of the asset being handed back to the Procuring Authority, or to a new Project Company or new operator. This transition is important as it will affect the ongoing provision of the public service, and the research indicates that it is sometimes not given the appropriate proactive, strategic consideration. The Project Company must comply with contractually stipulated handback requirements that should prescribe the asset condition to be demonstrated at the end of the contract term. The required asset condition may be described by technical standards, which should be measurable in order to be verified independently.

A key challenge at the handback stage is the commercial pressure for the Project Company to drive economic efficiencies in its maintenance activities in the period leading up to handback, which may lead to a deterioration in the asset condition. While there were limited examples of handback being implemented in the study, the research indicated that it is not unusual for the Project Company to 'sweat the asset' (i.e. try to extract as much value from the asset as possible while doing the least amount of maintenance, such that the asset handed back to the Procuring Authority is in need of extensive repair). If the Procuring Authority does not manage this phase adequately, it can find itself with an asset in an undesirable condition.

SUBSECTION STRUCTURE

This subsection provides guidance on managing handback. The key elements of successfully managing the transition are summarised below and detailed in this subsection under the heading 'Guidance':

A. Ensure the PPP contract contains protections around asset handback and that those protections are understood and utilised

B. Plan for handback (or the transfer to a new Project Company or operator) well in advance of the end of the PPP contract

GUIDANCE

A. Ensure the PPP contract contains protections around asset handback and that those protections are understood and utilised

Key contractual protections to mitigate the risk of deterioration in the asset condition prior to handback in a PPP contract are set out below. These protections are not addressed in detail in this reference tool, as they should be considered carefully when agreeing the PPP contract (which is not the focus of this reference tool). The protection mechanisms relevant to the PPP contract and project in question should be well understood and utilised to protect the interests of the Procuring Authority.

- PPP contracts should have a clear and well-defined asset handback standards to leave less room for the Project Company to hand back an asset in a substandard condition.
- Requiring the establishment of a contingency fund for any maintenance requirements after handback. Here the Procuring Authority will retain money (or security, such as a letter of credit) that can be used to complete required maintenance after handback. If there is no additional maintenance required, the money will be repaid to the Project Company, thus incentivising the Project Company not to 'sweat the asset'.
- The Project Company can be required to hand back the project to the Procuring Authority in a condition that would meet the handback standards as defined in the PPP contract for a specified period (e.g. five years after handback).

It is worth noting that very few PPP projects have reached the expiry date for some of these handback provisions to become effective. In other words, unlike other provisions of PPP contracts, the application of certain handback mechanisms is still largely uncharted territory from a global practice perspective.

EXAMPLE

Maintenance reserve account

For the Zaragoza Tramway project in Spain, the Project Company is required to pay 5% of its availability payments into a 'Reserve Account', which will be used to pay for any additional maintenance activities that are required leading up to handback.

For more information, see the Zaragoza Tramway Case Study.

B. Plan for handback (or the transfer to a new Project Company or operator) well in advance of the end of the PPP contract

The main approach the Procuring Authority can take to manage handback is to plan the process proactively. Depending on the size and complexity of the relevant asset, the Procuring Authority may need to start planning for handback three years or more before the expiration of the PPP contract.

It is recommended that consultation with relevant stakeholders take place at this early stage. This can assist the Procuring Authority to identify options for procurement strategies and/or potential operations contracts for the continuation of the services after handback has occurred.

A handback plan focuses on two key areas:

- Ensuring the asset meets the contractual requirement for handback
- Ensuring continuity of the service provided by the asset

On the first point, it is important that the Procuring Authority revisits the PPP contract and understands what the contractual obligations and entitlements are when the asset is handed back. The Procuring Authority must have a clear understanding of its goals for the end of the contract term, what the contract requires and what condition the asset is actually in leading up to handback. This will ensure the Procuring Authority does not receive the asset in a condition below the standards defined in the PPP contract.

Before commencement of the handback process, the Procuring Authority should also have a plan for how the testing and inspection of the asset condition will be performed, what audits will be carried out, and how the results will be used to measure compliance with the contract. During this process, the Procuring Authority should work with the Project Company to ensure both parties are aligned in terms of what condition the asset will be handed back in. If the asset is being transferred to a new Project Company or a new operator, that new Project Company should also be involved. This will benefit all parties, particularly where payments to the exiting Project Company are being withheld as contingency.

The Procuring Authority should also have a plan for how it will ensure service continuity. There should be a decision on whether the asset will be operated by the Procuring Authority, the current contract will be extended, a new operational contract will be tendered or a new PPP contract will be tendered. While the option of extending the existing contract may seem to be the most straightforward option, this is unlikely to provide the best value for money for the Procuring Authority, as the negotiation of the extension is typically carried out in the absence of competition.

In addition, as part of its transition to handback, the Procuring Authority should address issues such as the creation of an inventory of assets and goods, any indemnification required to a new Project Company or new operator (where the project is being retendered), and staff transfer, including budgeting issues related to new staff.

3.1.4 Change in government administration or government policy

The research highlighted that the transition from one government administration to another or a change in policy or law or regulation may create similar challenges to those described above in this section 3.1.

Where any major change is required on a project, particularly where it involves subsequent personnel change, it is important that the transition is 'led from the top' of the Procuring Authority, in order to demonstrate the highest level commitment to the strategy and ongoing commitment to the project.

Changes to the contract management team should be considered where there is a substantial change in government or policy that affects the project. Carefully managed knowledge handover based on robust information management systems play an important role in circumstances involving personnel change, as detailed in Section 3.4 (Information Management) and Chapter 2 (Contract management team set-up and training).

The Procuring Authority can mitigate the risk of a change in government administration affecting the project by setting up a dedicated project team that has some independence.

Where a Project Company's ability to meet its contractual requirements materially changes as a result of a change in policy, law or regulation, it will typically expect to be compensated. This can be implemented through various mechanisms in a PPP contract such as a change in law claim or an economic rebalancing, which can be managed by deploying specialised legal or other expertise. These types of claims are detailed in Section 3.5 (Claims). The changes may have broader implications and a contractual amendment may be required, which is detailed in Chapter 4 (Renegotiation).

EXAMPLE

Dedicated project team

The Procuring Authority on the Queen Alia International Airport Expansion project in Jordan set up a dedicated project team. The Project management Unit raised project concerns with regulatory and permitting agencies, helping to facilitate its resolution. It also provided stability under multiple Transport Ministers.

For more information, see the Queen Alia International Airport Expansion case study.

3.2 Performance monitoring

Performance monitoring is a key aspect of the Procuring Authority's role in managing the PPP contract. The principal objective of performance monitoring is to ensure that the Procuring Authority is receiving the service the Project Company has agreed to deliver, and to confirm the risk allocation on an ongoing basis as agreed in the PPP contract.

A key benefit of the PPP model is that significant risk is transferred to the Project Company because it is well-placed to, manage that risk more efficiently. The Project Company is typically responsible for both construction and operation of the project assets, and is best placed to engage and manage its contractors and the involvement of other stakeholders. The priority of the Procuring Authority is therefore to ensure that the performance monitoring mechanisms set out in the PPP contract are properly followed, and that risk as allocated in the contract remains with the Project Company. The resources required from the Procuring Authority should not be underestimated.

SECTION STRUCTURE

This section provides a background to performance monitoring in Subsection 3.2.1 (Background) and provides guidance on managing the performance of the Project Company. The key elements to successfully managing performance are summarised below and detailed in Subsection 3.2.2 (Guidance):

A. Ensure adequate resourcing is employed for performance monitoring activities

B. Utilise interim construction milestones to stay well-informed on the progress of works

C. Be aware of and use the most efficient performance monitoring tools, including automated reporting

D. Use KPIs and payment mechanisms to ensure the Project Company is performing in accordance with the PPP contract, not as punitive measures

E. Assess the operational effectiveness of KPIs before operations commence or early in the operations phase, and on an ongoing basis

F. Clarify the intended application of KPIs that are perceived as being unclear or ambiguous with the Project Company

G. Closer performance monitoring will be required for risks that cannot be transferred to the private sector due to their inherent nature

H. Keep good records of performance data for use more broadly

3.2.1 Background

Typical performance monitoring mechanisms

There is a range of performance monitoring mechanisms that can be used during both the construction and operations phases of a PPP, which are typically associated with payment (e.g. payment deductions to penalise underperformance) to incentivise the Project Company's better performance. These mechanisms typically include:

- construction milestones reliant on completion of agreed sections of work, subject to quality requirements
- construction look-forward or look-ahead tests
- review and analysis of compliance with KPIs
- review of quality control and quality assurance procedures to ensure that quality systems are in place and effective
- informal audit processes, or conducting surveys and interviews to gauge user satisfaction
- independent monitoring by the Procuring Authority to verify the accuracy of the reporting delivered to the Procuring Authority
- independent calibration of measurement equipment used in the delivery of the service to verify its accuracy

Monitoring of performance will have different characteristics during the construction and operations phases. Construction milestones are the primary performance monitoring tool available to the Procuring Authority during the construction phase, while KPIs are the primary performance monitoring tool during the operations phase. Where the operation of existing assets takes place at the same time as construction and expansion activities (e.g. on a brownfield project or one with phased commencement of operations), operational KPIs and construction milestones may be combined.

Self-monitoring

The Project Company typically reports on its own performance following the quality management plans. These documents are developed by the Project Company and reviewed by the Procuring Authority. They set out activities, standards, tools and processes to be followed in order to achieve quality in the delivery of the project. The onus is on the Procuring Authority to ensure compliance of the Project Company with the prescribed quality plans, undertake spot checks, testing and physical inspections, and provide any sign offs and certifications required by the PPP contract. The ability to make enquiries against performance monitoring is an important right for the Procuring Authority. It is a right that needs to be exercised properly to ensure the Project Company is complying with the PPP contract and the Procuring Authority is receiving value for money.

The level of monitoring input from the Procuring Authority may depend on the quality of the self-monitoring procedures and systems deployed by the Project Company. It is common for these tasks to be completed in conjunction with an independent certifier during construction (as is discussed below) or with other technical consultants during operations.

Key Performance Indicators

KPIs are designed to allow the Procuring Authority to measure the level and quality of service that is being provided. They are a collection of measurable indicators of performance chosen to reflect how well the Project Company is providing the service that the project was designed to deliver.

Monitoring KPIs is the primary way the Procuring Authority ensures it is receiving the level of service prescribed in the PPP contract during operations. Service delivery should demonstrate soon after commencement whether the KPIs and the payment mechanism are working as intended, and if the associated contract drafting is clear in the recording of performance levels and application of the payment deductions. Where the KPIs and associated payment mechanism have been adequately designed, their application by the Procuring Authority should provide the Project Company with a real incentive to perform.

There is a conceptual difference in how performance monitoring should be implemented during operations depending on whether the PPP is based broadly on an availability payment model or on a user-fee model.

- Where the PPP uses an availability payment model, the Procuring Authority is the ultimate customer of the service being provided, and therefore has a pressing need to ensure that the quality targets are being met. For these types of projects, use of detailed KPIs is common.
- Where the Project Company earns its revenue from user fees or tariffs, it is holding some of the quality risk; a reduction in service levels and user dissatisfaction can lead directly to a reduction in revenue. As the Project Company is incentivised to provide a quality service to maximise its revenue, detailed KPIs become less crucial. However, the Procuring Authority cannot take an entirely

hands-off approach. It is likely that there will be aspects where poor performance of the Project Company (e.g. failing to perform long-term maintenance or failing to provide a safe working environment) may not adversely affect the Project Company's short-term revenue, but may have an adverse impact on the Procuring Authority. The KPIs in these projects should also consider aspects that do not lead to reduced revenue but nevertheless constitute reduced performance. For example, it can take a long time after the appearance of potholes on the shoulder of a road for road users or safety concerns appearing for road users or airport passengers to look for alternatives that may be less convenient to them.

KPIs will depend on the asset type. For example, KPIs may be punctuality indicators for rail projects, time of unavailability for power supply or transmission projects, lane availability for road projects, water leakage rates, social acceptance surveys, response times, etc.

The level at which to set KPIs when negotiating the PPP contract is an ongoing challenge. The study found examples where KPIs were considered very difficult to meet as well as examples where KPIs were too vague. The over-specification of KPIs can mean that payment deductions associated with the KPIs are so minor that monitoring does not provide value for money. The Project Company may also make a decision that the cost of compliance is higher than the relevant payment deduction, incentivising it to simply ignore the KPI. The correct level of KPIs and their flexibility is a complex topic in itself and not covered in detail in this reference tool.

EXAMPLE

Different levels of KPIs

On the Segarra Garrigues Irrigation System project in Spain, there are requirements to repair all damage to certain irrigation facilities within 48 hours, regardless of the scale of damage. This has the potential to sour relationships between parties, with the Project Company and its contractors feeling that they are being held to an unobtainable standard, and the Procuring Authority being put under pressure to waive deduction rights. In another example from the study, the Project Company felt that it barely had to consider the KPIs, as they were set so low, which suggests that the KPIs were not designed to incentivise good performance or penalise failures in performance standards.

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

Payment mechanisms

Payment mechanisms come in the form of a range of financial incentives including increased unitary payments to the Project Company, lump sum payments (e.g. attached to a construction milestone), payment deductions, agreed compensation, adjustment of rights to receive revenue from the project, changes to the required level of investment by the Project Company, etc. The key is that there will be either a positive or a negative impact on the Project Company's revenue depending on the level of performance.

Failure to meet KPIs will typically result in a corresponding payment deduction or agreed compensation payable to the Procuring Authority.

Payment mechanisms during construction are typically tied to construction milestones, subject to quality requirements. Many PPP projects will involve no payment to the Project Company during construction, as payment is linked to availability of services or user fees during operations. This structure incentivises the Project Company to complete work within the agreed timeframe, as availability of revenue is dependent on completion of the construction works, and so late delivery will erode potential Project Company profit (in addition to any agreed compensation payable because of the late delivery). This structure still provides the Project Company with the autonomy it needs to properly manage its contractors.

The payment mechanisms during construction may be one-off lump sum payments for the completion of milestones implemented through an increase in the unitary payment as milestones are reached, or as a deduction from the unitary payment until the milestones are reached.

EXAMPLE

Milestone payments

Milestone payments were used successfully in a number of case study projects. On the Zaragoza Tramway project in Spain, 10% of the subsidy from the Procuring Authority was dependent on the achievement of certain milestones, while a substantial payment was available on completion of the Port of Miami Tunnel project in the USA. These were seen as useful incentives for on-time delivery.

For more information, see the Zaragoza Tramway and Port of Miami Tunnel Case Studies.

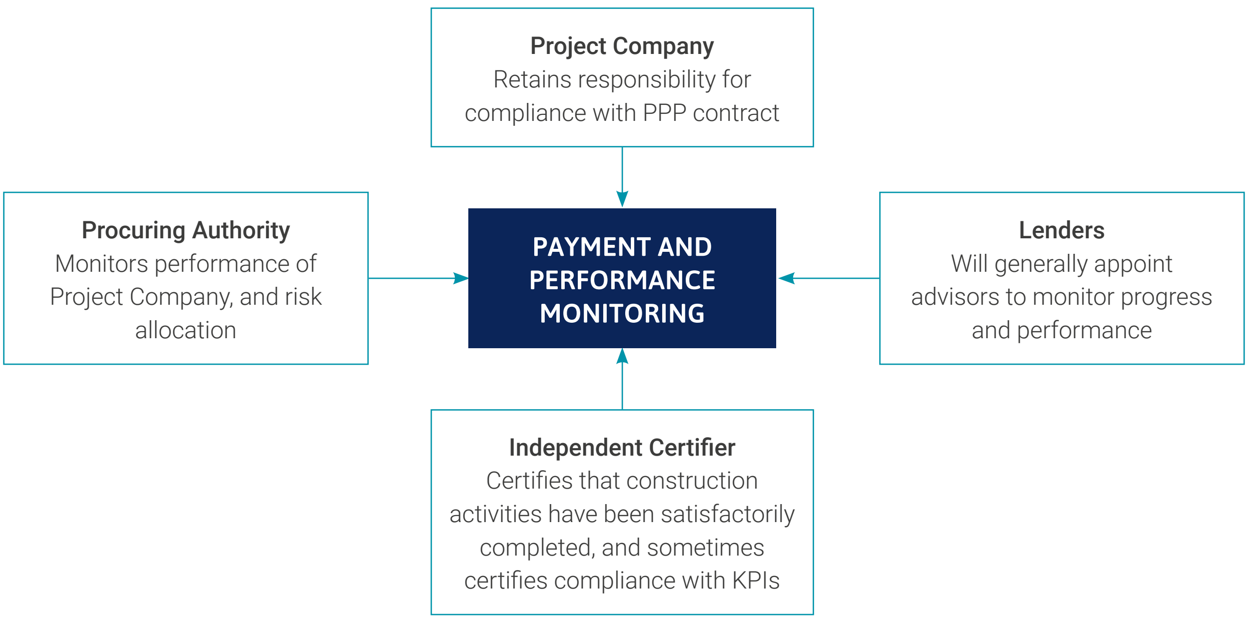
Independent monitoring

It is common to employ independent certification/verification, in particular during the construction period. This involves an independent certifier that is commonly appointed during construction under a tripartite agreement between the Project Company, the Procuring Authority and the independent certifier to monitor compliance with the output specifications, overall progress and quality control. In addition, a third party technical advisor is typically appointed by the lenders to monitor construction progress and approve Project Company loan drawdowns when payments are due to the construction contractor.

For complex projects, the independent certifier appointed by the Procuring Authority and the Project Company may continue its role during the operations phase in a more limited or ad hoc capacity.

An additional safeguard is the lenders' oversight of the Project Company's compliance with the PPP contract. The interests of the lenders and the Procuring Authority are aligned on this issue of compliance, as any material underperformance by the Project Company will ultimately affect the Project Company's cash flows (through payment deductions) and the Project Company's consequent ability to service its debt. However, it should be noted that this scrutiny may be limited. The lenders exercise this scrutiny through their independent technical advisor's reporting on the project's operational performance, which is typically not shared with the Procuring Authority.

Figure 2: Performance Monitoring roles and responsibilities



3.2.2 Guidance

The following guidance outlines the key issues that should be considered monitoring the performance of a Project Company in relation to a PPP contract.

A. Ensure adequate resourcing is employed for performance monitoring activities

PPPs are typically based on the principle of self-monitoring by the Project Company and consequently there will be a large volume of regular reports to be submitted to the Procuring Authority to verify and approve. The reports need to be well understood and analysed, and data interpretation is resource intensive.

The Procuring Authority should scrutinise how well the Project Company's self-monitoring is working and alter its internal procedures accordingly. Where the Procuring Authority is not satisfied with the quality of the service being provided by the Project Company, it may be appropriate to increase its own level of monitoring. Some PPP contracts also give the Procuring Authority the right to increase its monitoring at the cost of the Project Company.

The priority of the Procuring Authority is to ensure that the performance monitoring mechanisms are properly followed and that risk as allocated in the PPP contract remains with the Project Company.

The Procuring Authority may be required to sign off completion of works so operations can commence. This process is typically defined as the testing and commissioning phase and is detailed in Section 3.1 (Transitions).

Once in operation, one of the primary obligations for the Procuring Authority, particularly in availability-based projects, is to pay the Project Company. Payment should not be delayed because the Procuring Authority does not have sufficient time to undertake its review of the Project Company's monitoring reports. Late payment can create substantial concerns for the Project Company, cashflow difficulties and anxiety on the part of operations contractors.

EXAMPLE

Performance monitoring team in Spain

The Procuring Authority for the Zaragoza Tramway project in Spain had four dedicated staff responsible solely for performance monitoring. Other case studies showed that less staff was required but these cases typically relied more on consultants.

For more information, see the Zaragoza Tramway Case Study.

B. Utilise interim construction milestones to stay well-informed on the progress of works

The design and construction monitoring structure often involves the use of key interim milestones as either progress monitoring or payment incentive tools. The interim milestones can assist the Procuring Authority to monitor the progress of the works all the way through construction. The use of interim milestones can be particularly helpful where there are separable parts of a major project that can commence operations early.

The interim milestones may introduce additional payment mechanisms on the completion of an agreed section of work to incentivise performance.

The use of interim milestones may be more important on large and complex projects that consist of a number of discrete packages of work. The application of interim milestones enables the Procuring Authority to gain an early indication of any delays that can be mitigated before they affect the overall completion deadline and compromise the delivery of the public service.

EXAMPLE

Interim milestones on large and complex projects

The Procuring Authority on a light rail project in a developed market noted that the lack of interim milestones combined with the complexities of the work made it more difficult for the Procuring Authority to monitor the construction schedule. Milestones can also be associated with lump sum payments as an incentive for the Project Company, which was not present on this project.

C. Be aware of and use the most efficient performance monitoring tools, including automated reporting

A common tool used to monitor KPIs during operations is a Quality Management Plan, which is developed by the Project Company and then reviewed by the Procuring Authority. This document sets out who will do the operations and maintenance work, how it will be inspected and how the findings will be reported by the Project Company back to the Procuring Authority. The PPP contract also typically sets out specific reporting requirements.

The Procuring Authority should rely on the Project Company's reporting to some extent but should also make itself comfortable that the performance data provided is accurate. A variety of methods are available for this, including user satisfaction surveys, spot checks and testing, inspections, and reviews of complaint logs and help desk records.

The key is to ensure that the level of detail, format and frequency of performance reporting contractually required and operationally requested from the Project Company is adequate for the Procuring Authority's needs, and can facilitate independent monitoring and verification. Sometimes the information provided (by the operations contractor through the Project Company) is deficient, and parties should be encouraged to meet and review this process.

For complex projects, the parties may also jointly appoint an independent consultant to assist with the performance monitoring during operations.

Compliance with some KPIs can be automatically generated by the software that controls the asset's operation. For example, some KPIs associated with delays on a rail project are automatically generated by the software that controls the operation of the rolling stock (times of arrivals and departure in all stations, speed, location of the rolling stock, etc.).

EXAMPLE

Monitoring KPIs

The Procuring Authority on the Zaragoza Tramway project monitors the KPIs very carefully. The KPI regime is comprehensive, covering quality and availability measures, and four employees work full-time on this task. The Procuring Authority considers that this approach leads to high quality service delivery.

For more information, see the Zaragoza Tramway Case Study.

D. Use KPIs and payment mechanisms to ensure the Project Company is performing in accordance with the PPP contract, not as punitive measures

The Procuring Authority should not take a 'soft stance' on the enforcement of payment deductions as they relate to KPIs. KPIs embody the level of service and the allocation of risk that was agreed to in the PPP contract and so should be appropriately managed to ensure the Project Company is performing in accordance with its contractual obligations. The approach taken by the Procuring Authority should be 'strict but fair'.

It is not uncommon for there to be some disagreement between the Procuring Authority and Project Company over KPIs at some stage during a project lifecycle, with the study data showing 20% of disputes in PPPs globally involve KPIs. Disputes are detailed in Chapter 5 (Disputes). At a fundamental level, the incentives of each party are divergent with regard to KPIs, as the Procuring Authority wants the highest level of service for the lowest price to deliver the greatest value for money to the public, and may be incentivised to apply payment deduction strictly. On the other hand, the Project Company wants to deliver what is required in the most cost effective way for the highest revenue. These opposing drivers increase the likelihood of a disagreement or dispute. For example, in the research there were a number of instances where the Project Company perceived KPIs as too onerous or unrealistic, while the Procuring Authority saw them as a means of 'keeping pressure' on the Project Company to perform.

Both parties should acknowledge the inherent divergence of interests, and approach KPIs with an open mind to work together to resolve any operational difficulties. Application of payment deductions has the strong potential to damage the relationship between the Procuring Authority and Project Company. The main objective is to ensure proper service delivery and not to use payment deductions as punitive measures, as this puts the relationship at risk and will not improve long-term value for money. Stakeholder management with respect to the Project Company is detailed in Section 3.3 (Stakeholder management).

In certain circumstances the Procuring Authority may decide not to enforce its contractual right to impose a payment deduction or a penalty if it considers there is an overriding interest for it not to do so. Similarly, it may decide to apply it at a lower level than contractually entitled. In these circumstances it is important to communicate clearly that the inaction is deliberate, and to clarify the grounds for the decision should similar circumstances arise in the future. Waiving rights under a contract should only be undertaken after receiving legal advice, to ensure an appropriate waiver is effected (i.e. that the Procuring Authority is waiving only what it is intending to waive and not waiving any other rights under the PPP contract). The Procuring Authority must weigh up the risk of damage to its relationship with the Project Company with the financial gain and precedent-setting of strictly applying the deductions.

EXAMPLE

Pro-active management of KPIs

There was an issue with excessive noise on the Brabo 1 Light Rail project in Belgium. The mitigation, was proactively managed by both parties. Data was collected during noisy periods and appropriate mitigations were developed and implemented.

For more information, see the Brabo 1 Light Rail Case Study.

E. Assess the operational effectiveness of KPIs before operations commence or early in the operations phase, and on an ongoing basis

KPIs are created during the procurement phase and agreed to in the PPP contract. However, they have to be considered from an operational, real life point of view. The Procuring Authority should be in agreement with the Project Company about what is required and work to ensure that KPIs are mutually understood. This needs to be addressed as early as possible once KPI measurement and assessment starts.

The Procuring Authority should regularly assess any KPIs that may be ineffective and, with the long-term success of the project in mind, decide if:

- certain KPIs (e.g. performance standards, rectification periods) or payment deductions should be amended for the benefit of the project
- a practical solution can be agreed with the Project Company as a way to manage difficult KPIs

As is detailed in Section 3.1 (Transitions), 'bedding-in' periods are also common at the outset of the operations phase to allow the parties to become familiar with their operations phase obligations.

EXAMPLE

Early collaboration on review of KPIs

The Procuring Authority and Project Company on the Port of Miami Tunnel project in the USA began collaborating with the operations contractor a year before operations were due to begin, to review KPIs and predict any challenges. The Procuring Authority assessed the issues raised by the contractor and concluded that one KPI relating to response times was not workable. All other KPIs were kept as described in the PPP contract.

For more information, see the Port of Miami Tunnel Case Study.

F. Clarify the intended application of KPIs that are perceived as being unclear or ambiguous with the Project Company

KPIs as drafted in the PPP contract may be unrealistic, ambiguous, difficult to implement in practice or no longer relevant. Procuring Authorities should not take advantage of unclear KPIs to the detriment of the Project Company and the Procuring Authority's relationship with the Project Company. Instead, the intended application of the KPIs should be clarified between the parties.

KPIs are generally defined in the PPP contract at financial close. For projects that can run for 20 to 30 years, this means that the indicators can become out of date due to external factors. For example, contracts that were drafted in 2005 are unlikely to have greenhouse gas emissions targets, yet a Procuring Authority may be more likely to have emissions targets defined in its current policies. Similarly, an airport may need additional capacity earlier in the contractual period, with the focus shifting to improved customer service later in the period.

Different approaches to dealing with this have included creating KPIs that are flexible to circumstances, such as factoring in specified review points on the original KPIs.

EXAMPLE

Outdated KPIs

The Central Berkshire Waste project in the UK was signed in 2006, at a time when the primary objective was to direct waste away from landfill. The Project Company was given the autonomy to achieve this however it saw fit (e.g. through incineration of waste). Current policy is now more focused on recycling and KPIs therefore do not correspond well to the new goals of the Procuring Authority. At the time of writing, the Procuring Authority is considering how to address this challenge.

In addition, the Procuring Authority realised that there were certain aspects of reporting that weren't covered clearly in the contract, however were still of interest. It therefore developed an informal audit. Conducted with the Project Company, it covers issues that may be more subjective and are not as clearly defined.

For more information, see the Central Berkshire Waste Case Study.

G. Closer performance monitoring will be required for risks that cannot be transferred to the private sector due to their inherent nature

One of the key elements of the PPP model is the transfer of risk to the Project Company; however, it should be emphasised that there is a range of public interest risks that will remain with the Procuring Authority regardless of the risk allocation. Aspects such as environmental issues, health and safety, or community engagement, where the actions (or lack of action) by the Project Company have the potential to affect the public, must be considered by the Procuring Authority. These issues have the potential to affect the reputation of the Procuring Authority, regardless of how the risk in question has been allocated.

The Procuring Authority has an obligation to monitor and support the Project Company, both to protect its own reputation if an incident were to occur, and for the fundamental reason that a government body should be concerned with the welfare of its citizens.

Issues regarding stakeholder management and engagement may present risks for the public and for the Procuring Authority, particularly on large and high-profile projects, which PPPs often are. Construction works have a significant effect on those who interact with the project in any way, whether through noise or vibration associated with the work itself, or the inconvenience of road closures. A lack of engagement will make the experience of those affected more difficult, as well as affecting the reputation of the Procuring Authority. Stakeholder engagement is detailed in Section 3.3 (Stakeholder engagement).

Where the risk and responsibility for stakeholder management and consultation is passed to the Project Company, there is a risk that the work done on that stakeholder management by the Procuring Authority pre-bid will be lost. The Procuring Authority should give careful consideration to remaining involved in stakeholder management to assist in ensuring appropriate behaviour of both the Project Company and the stakeholders.

There are several other matters that may threaten the ongoing provision of services that have the potential to become public interest issues. For example, when the Project Company experiences financial difficulties, even where they are entirely the result of the materialisation of risks allocated to the Project Company, if they lead to insolvency then services may be halted, which will affect the public. The issue of insolvency is detailed in Chapter 6 (Insolvency).

EXAMPLE

Environmental issues

The Project Company on a road project in a developed market agreed to pay compensation towards local community projects after it allowed water that had been polluted by construction works to enter the local waterways. The underlying cause of the incident was related to the unusual soil composition in the area (leading to higher than average settlement time and consequently the overflow of settlement ponds in heavy rain). The construction contractor was not accustomed to these conditions, and the Procuring Authority concluded that it could have emphasised this soil challenge more than it did and mitigated the risk.

EXAMPLE

Public engagement issues

On a light rail project in a developed country, there were issues that required third party stakeholder consent, and were therefore critical. The Procuring Authority took a proactive approach in facilitating these consents and managing the implications for the project. The Procuring Authority established its own stakeholder management team, and is considering retaining this risk for future projects to avoid the costs of duplicating the work with the Project Company.

On the Port of Miami Tunnel project in the USA, the construction contractor faced some challenges in terms of compliance with federal labour laws. It highlighted the importance of the Procuring Authority ensuring that the Project Company and its contractor are fully aware of the relevant laws. On this project, the Procuring Authority was also liable for fines if any of its projects were not compliant with relevant laws and regulation.

For more information, see the Port of Miami Tunnel Case Study.

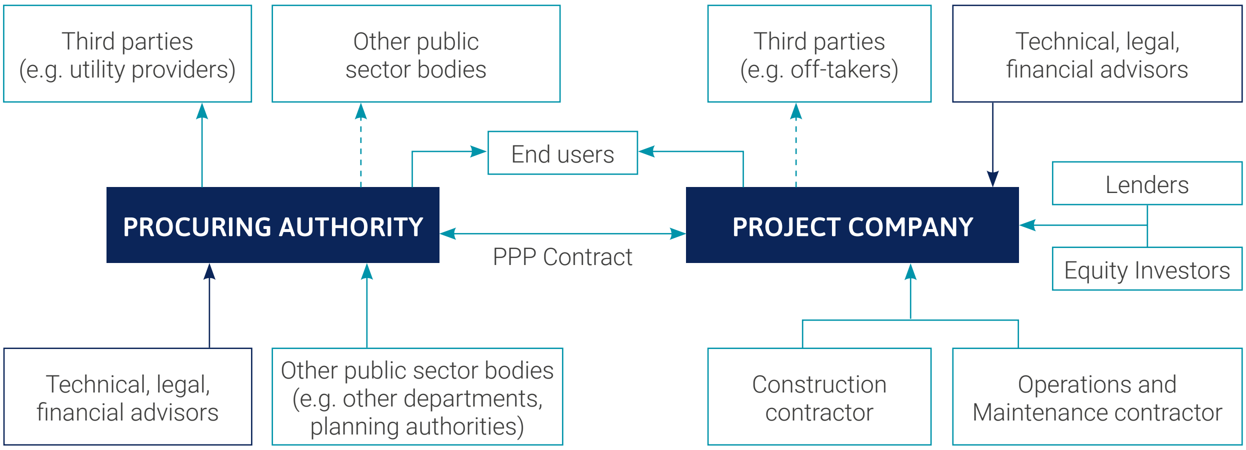
H. Keep good records of performance data for use more broadly

The Procuring Authority should recognise the broader value in performance data, and should collect performance data for a variety of reasons: as benchmarks for other projects, to inform policy development, and to feed into reporting requirements to the regulators or central government. To the extent performance data is available from other projects, that data can also be used to better assess the performance of the Project Company on a particular project, as it can benchmark against similar projects. Information management is detailed in Section 3.5 (Information management).

3.3 Stakeholder management

By their very nature, PPP projects involve a vast array of interconnecting relationships. This is not just between the Procuring Authority and the Project Company, but with and between other stakeholders including end-users, the public, equity investors, lenders, contractors, insurers, advisors, other government departments, and PPP units. Figure 3 illustrates the potential relationship complexities involved in a PPP transaction.

Figure 3: Typical PPP stakeholders



PPPs have the potential to create an environment of collaboration and mutual benefit, where improvements and efficiencies can lead to increased value for the government, high quality services for end-users, and commercial benefits for the private parties. The achievement of these goals depends, to a large extent, on how well the relationships between the parties are managed, as poor relationship management can have significant knock-on effects.

SECTION STRUCTURE

This section provides guidance on managing relationships with three key stakeholder groups: the Project Company and its associated private partners (equity investors, lenders, contractors); end-users and the community; and other government agencies. The key elements of successfully managing stakeholders are summarised below and detailed in Subsection 3.3.1 (Guidance), Subsection 3.3.2 (Guidance: Project Company), Subsection 3.3.3 (Guidance: private partner stakeholders other than the Project Company), Subsection 3.3.4 (Guidance: end-users, businesses and the community) and Subsection 3.3.5 (Guidance: other government agencies).

A. Define all stakeholders that are relevant to the project

B. Ensure good communications strategies and practices are developed

C. Keep good records of communications, including informal communications

Project Company

D. Consider the interests of the Project Company, including any changes in its circumstances

E. Ensure appropriately frequent meetings are held, including at the relevant strategic levels

F. Follow formal communication requirements where required

G. Be aware of the positive and negative aspects of appointing Project Company board members

H. Consider co-location of office space with the Project Company, which can benefit the relationship

I. Use contractual provisions to protect the rights of the Procuring Authority rather than as punitive measures

J. Focus on a positive relationship, even in the presence of ongoing disputes

Private partner stakeholders other than the Project Company

K. Consider associated private partners (including the construction contractor) in communications and relevant meetings

End-users, businesses and the community

L. Ensure end-users, businesses and community stakeholders are engaged at all stages of infrastructure delivery to ensure viability and enhance the services

M. Ensure ongoing transparent engagement with ends user, business and community stakeholders on all relevant issues

N. N. Define the role of the Project Company in the management of end-user, businesses and community stakeholders

O. Consider each relevant community group, as they may have different interests and desired outcomes

Other government agencies

P. Consider the level of involvement required from other government agencies

Q. Set up effective governance structures to manage the relationships with other relevant government agencies

R. Collaborate with the Project Company to work with other government agencies, where appropriate

S. Plan early for managing other government or quasi-government agencies that the Procuring Authority does not have influence over

3.3.1 Guidance

A. Define all stakeholders that are relevant to the project

As PPPs typically involve a vast array of interconnecting relationships, the Procuring Authority should map and define all relevant stakeholders from very early on in the process. There are a few key groups: the Project Company and its associated private partners (equity investors, lenders, contractors); end-users; businesses and the community; and other government agencies. Additional third parties should also be considered, such as private operators of interfacing projects, independent regulators, utility providers, insurers and advisors.

The relationship between the Procuring Authority and the Project Company is key to the success of a PPP. A collaborative relationship helps the parties ultimately achieve 'win-win' solutions, while a breakdown in relationship can amplify disputes and threaten the ongoing viability of the project.

External stakeholders, such as members of the public or end-users of the service, need to be engaged and managed by both the Procuring Authority and the Project Company. These stakeholders can include different members of the public and end-users, such as communities, developers, local businesses, utilities providers and other interest groups. Infrastructure projects have the potential to cause disruption to these groups, and if relationships are not managed properly they may create opposition to the project and cause serious and costly delays, as well as underutilisation of the infrastructure.

Another key group of stakeholders that the Procuring Authority must consider are other government departments. For example, approvals will generally be required from the ministry of finance (or equivalent). Other bodies will be relevant: PPP units, bodies that regulate the provision of services (such as power), planning and environmental regulators, health and safety regulators, etc. The Procuring Authority will need to ensure good relationships are maintained with all relevant government bodies.

EXAMPLE

Different stakeholders

The stakeholders in PPPs can be very diverse, depending on the project and sector.

On the Queen Alia International Airport Expansion project in Jordan, as with all airports, the users of the facilities are members of the public, retailers, and airlines. All of these groups have different views and need to be engaged with in distinct ways.

For more information, see the Queen Alia International Airport Expansion Case Study.

B. Ensure good communications strategies and practices are developed

Effective communication is imperative to maintain a positive relationship between the parties to the PPP contract and with third party stakeholders, working towards shared benefits. The Procuring Authority should establish a communication strategy and plan from day one. The Procuring Authority should design and implement a communication strategy to address communication requirements with all relevant project stakeholders. This is important across all stages of a project.

The Procuring Authority should define:

- All of the stakeholders with which it needs to regularly communicate with, as well as the stakeholders' roles and interests
- The frequency and type of communication needed with the Project Company and other key stakeholders, including the community, end-users and other government agencies
- The level and nature of the input required from the Procuring Authority's team with regard to each relationship
- The level of support which can be provided at central government level and from other industry bodies or regulators, and how to manage those relationships
- Reporting requirements to central government and any regulatory body

The communication strategy should include an awareness campaign, regular progress updates, mitigation measures for any issues affecting end-users and/or the community, crisis communication procedures, clear protocols for responding to queries from the public and media enquiries and a dedicated website for disseminating key controlled messages.

It is also important that communication within the Procuring Authority team takes place regularly. The senior management team should be aware of the state of the relationship between the contract management personnel and their counterparts, and the messaging at all levels should be consistent.

EXAMPLE

Communication over a large area

A project in North America involved work on 20 separate sites, which were spread over a large geographical area. Communication between the different teams was vital to avoiding disagreements escalating into disputes.

C. Keep good records of communications, including informal communications

While verbal communication is useful in avoiding excessive formality, it is important that these exchanges are well documented to avoid confusion. This can be done by recording and sharing key action points agreed upon in informal discussions and sharing and agreeing on the minutes which are taken during formal meetings. Preparing high quality minutes is particularly important to accurately reflect the spirit of the agreements made and help to bind the relevant participants to their commitments. Information management is detailed in Section 3.4 (Information management).

3.3.2 Guidance: Project Company

D. Consider the interests of the Project Company, including any changes in its circumstances

The relationship between the Procuring Authority and the Project Company is key to the success of a PPP. The first step in managing the relationship with the Project Company is to ensure that both parties have a good understanding of one another's objectives and points of view. This will create a common vision and boost cooperation and also help avoid surprises. Goals and expectations should be made clear as early as possible and discussed openly. While this will often be covered in the procurement phase, they should be revisited at regular intervals, such as during transitions between project phases, when staff are likely to change, as is detailed in Section 3.1 (Transitions).

As PPPs are long-term partnerships, team dynamics and personalities play an important role in defining the primary relationship between the Procuring Authority and the Project Company.

Although the Project Company and the Procuring Authority may have different commercial and non-commercial drivers and incentives, they are ultimately delivering the same project and a collaborative approach is important. The Procuring Authority should seek information on how it is regarded by the Project Company, with a view to improving the relationship over time.

A positive relationship between the Procuring Authority and the Project Company is also a responsibility of the Project Company. Various factors may affect how the Project Company will approach the relationship with the Procuring Authority including its underlying financial situation, its equity investors' priorities and whether adequate personnel and resources have been allocated to the project.

For example, there may be circumstances where the underlying financial situation of the Project Company will influence its willingness to engage in collaborative behaviours. When the Project Company is making a healthy profit, it may be more likely to be more flexible and cooperative in achieving shared wins, even if those changes do not have an obvious financial benefit. On the other hand, if the underlying economics of the Project Company's role in the project are not as positive as expected, there is likely to be pressure on the Project Company to cut costs, which may have an impact on the relationship. This situation highlights the importance of maintaining good communication between the parties, so the Procuring Authority knows what is happening and how it may be able to best work with the Project Company.

EXAMPLE

Advantages of a strong relationship

The Intercity Express Programme project in the UK was forced to make changes to the train design due to delays in external infrastructure works, and the close working relationship between the Procuring Authority and Project Company allowed them to mitigate the delay.

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

E. Ensure appropriately frequent meetings are held, including at the relevant strategic levels

Successful projects generally recognise the importance of timely resolution of day-to-day operational issues through the involvement of relevant representatives from the Procuring Authority and Project Company, and high-level effective decision-making on strategic matters which determine the future of the project. The latter is required less frequently but must include all relevant stakeholders from the public and private sector side, and not just the respective Project Company and Procuring Authority representatives.

It is common for the Procuring Authority and Project Company to discuss operational issues at regular meetings, though the frequency may vary depending on the project from weekly to quarterly.

The relationship between parties may also operate at different levels. Parties from both sides involved in the day-to-day running of the PPP contract should communicate frequently on operational matters, in both a formal and informal context.

Conversely, senior management may limit communication to strategic questions and other major issues and may communicate in a more formal way. There should be a clear hierarchy regarding the importance of issues dealt with by the Procuring Authority contract management team. It needs to distinguish between everyday operational management issues (ordinary issues which are monitored on a regular basis), and strategic issues with material commercial implications, which are discussed periodically or as the need arises.

Specific circumstances may warrant more frequent meetings, or meetings attended by specific additional representatives (e.g. to settle disputes). Disputes are detailed in Chapter 4 (Disputes).

EXAMPLE

Frequency of meetings for different projects

In the Gautrain Rapid Rail Link project in South Africa, important issues could be raised during weekly meetings between key representatives. In the Port of Miami Tunnel project in the USA, weekly meetings were held, which included the Procuring Authority, the Project Company and the construction contractor, as well as representatives from city and county governments. In other projects, meetings take place on a monthly basis, and in the Brabo I Light Rail project in Belgium, meetings were held quarterly. The Procuring Authority for energy projects in Brazil has recently introduced quarterly contract management meetings for all its projects.

For more information, see the Gautrain Rapid Rail Link Case Study, Port of Miami Tunnel Case Study and the Brabo I Light Rail Case Studies.

EXAMPLE

Frequency of meetings to settle disputes

One case study in a developed market identified the use of a ‘chairmen’s meeting’, which included representatives from the Procuring Authority, the Project Company, the construction contractor and the operations contractor during a time of ongoing disputes. These meetings took place for six months on a fortnightly basis and successfully enabled the resolution of many issues.

F. Follow formal communication requirements where required

Some Procuring Authorities adopt a more formal approach, with official letters used as the primary form of communication. This is a requirement of the Brazilian administrative system, and therefore is the approach taken by Procuring Authorities there. This approach is also common in India.

The PPP contract will usually identify formal points of contact and formal means of reporting and communication. However, several other less formal contact points and means of communication will generally also be beneficial. Channels of communication must be properly managed to ensure that they are efficient.

G. Be aware of the positive and negative aspects of appointing Project Company board members

Some government require an equity interest in Project Companies, with an accompanying right for the Procuring Authority to appoint a director to the Project Company's board.

There are several benefits of this, including sharing in the profits of good performance, enhancing the relationship and communications, assisting to raise issues at a strategic level, increasing the level of transparency and information management.

There are also negative aspects including sharing of losses, blurring the line between the public and private sector interests and creation of conflicts of interest. It is typically not a preferred structure for other private sector investors (including equity investors and lenders), who will require strict controls around what rights the directors who are appointed by the Procuring Authority have at the board level. Additional challenges will arise in the case of financial difficulty or insolvency of the Project Company, as detailed in Chapter 6 (Insolvency).

EXAMPLE

Procuring Authority appointed directors

In the Qiaoxi District Central Heating project in China, the Project Company governance structure includes a board of directors and a supervisory committee. At least one of the five members of the board and at least one of the three members of the committee must be from the government of the Qiaoxi district in China. This allows the Procuring Authority to monitor the performance of the project on an ongoing basis.

In several PPPs in Scotland, the Procuring Authority has an observer who sits in on the board meetings of the Project Company (other than during shareholder-related commercial discussions).

For more information, see the Qiaoxi District Central Heating Case Study.

H. Consider co-location of office space with the Project Company, which can benefit the relationship

Co-location of office space with the Project Company can also be beneficial in many circumstances. While this may only be feasible in certain situations, it has obvious advantages, such as the ability to have more regular informal conversations in addition to formal meetings.

Where the Procuring Authority and Project Company choose to co-locate, there are risks regarding confidentiality and independence which must be managed.

EXAMPLE

Decision to co-locate

The operational team for the Central Berkshire Waste project in the UK are co-located, and this was seen as beneficial in keeping the relationship between the Procuring Authority and Project Company amicable, even during an ongoing dispute.

For more information, see the Central Berkshire Waste Case Study.

EXAMPLE

Decision not to co-locate

This team for the InterCity Express Programme project, also in the UK, highlights that some parties deliberately decided not to co-locate their offices to maintain a degree of separation and independence, which was felt to be more appropriate under the circumstances.

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

I. Use contractual provisions to protect the rights of the Procuring Authority rather than as punitive measures

The Procuring Authority should not unfairly use contractual mechanisms to address relationship issues or resolve issues that it may have outside of the project.

For example, the contractual entitlement to deduct payments should not be perceived as a means to generate savings for the Procuring Authority, and unnecessarily penalise the Project Company. Performance monitoring and application of payment deductions is detailed in Section 3.2 (Performance monitoring). The relationship between the parties can be improved only through communication and collaboration, while contractual mechanisms are there to help the Procuring Authority enforce its contractual rights.

As discussed above, the relationship with the Project Company may be impacted by its financial situation. Pressure on costs can also come from the Procuring Authority side, due to budgetary pressures and changing priorities from broader government policies. This can put contract managers from the Procuring Authority into a difficult situation, however they must be aware that, even when under budgetary pressure, the relationship with the Project Company continues to be extremely important.

J. Focus on a positive relationship, even in the presence of ongoing disputes

During disputes, it is important that the underlying principles of communication outlined above continue to be followed, despite the challenges raised during the process of resolving a disagreement.

Major changes, such as unforeseen events and other major challenges, may also call for a change in the personnel dealing with the challenge from the Procuring Authority's team. If the Procuring Authority is facing a major dispute or claim, then people with strong relationship-building skills might help improve the existing relationship, which could be tense. Disputes are detailed in Chapter 5 (Disputes).

EXAMPLE

Treatment of disputes

Several projects have highlighted how the relationships between the Procuring Authority and Project Company remained positive throughout all commercial disagreements and formal disputes. This was achieved by separating disputes from day-to-day operational matters, and in the Central Berkshire Waste project in the UK, the fact that the offices were co-located was also helpful.

For more information, see the Central Berkshire Waste Case Study.

3.3.3 Guidance: private partner stakeholders other than the Project Company

K. Consider associated private partners (including the construction contractor) in communications and relevant meetings

The Procuring Authority needs to keep in mind that it should not consider the Project Company as the only private partner; in fact, it is working with several private partners or private parties (including the Project Company, its equity investors, lenders, construction contractors and operations contractors). All these parties play different roles, and although it is important to remember that the Project Company is responsible for managing these relationships, the Procuring Authority should still be considerate of their existence and the interests of those parties after financial close.

For example, the Procuring Authority could invite the additional stakeholders to induction seminars to help improve their understanding of the government's objectives of the project, or to invite the additional stakeholders to other meetings between the Procuring Authority and the Project Company, as relevant. This must be done while diligently observing relevant confidentiality requirements.

One useful approach is to include the construction contractor in the dialogue between the Procuring Authority and the Project Company where there is a dispute over construction scope changes or other issues. The construction contractor will ultimately need to agree to the arrangements agreed between the Procuring Authority and the Project Company and involving the construction contractor at an early stage is likely to provide the most beneficial outcomes. Disputes are detailed in Chapter 5 (Disputes).

In several jurisdictions, the Procuring Authority will also agree with the Project Company and the construction contractor that it will have the opportunity to step in and cure a default related to non-payment to the construction contractor where the Project Company has not paid the construction contractor. Potential Project Company non-payments should be monitored to ensure the construction contractor can deliver the construction works and will not fall into financial difficulties. Procuring Authority step-in rights are detailed in Chapter 7 (Default and termination).

3.3.4 Guidance: end-users, businesses and the community

L. Ensure end-users, businesses and community stakeholders are engaged at all stages of infrastructure delivery to ensure viability and enhance the services

The level of input required from stakeholders should not be underestimated, and feedback at all stages of a project can ensure the project is continuing to deliver value for money to the government and the community. Members of the local community will typically know the area well and may be able to contribute positively to project planning and enhance the value of the project.

On the other hand, insufficient consultation can be detrimental to the completed project. For example, many PPPs globally have been adversely affected by land acquisition issues, and other communication failures with stakeholders, identifying a strong lesson to be learned from past experience.

EXAMPLE

Negative impacts of poor stakeholder engagement

The relationship with the end-users is a key ingredient to the success of a project. On the Segarra Garrigues Irrigation System project in Spain, farmers were required to agree to and provide their own capital to connect to the water network. This only occurred after an improved stakeholder management plan was implemented and much of the delay that occurred on that project was due to the reluctance of these landowners to engage with the development.

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

Public stakeholder engagement can also provide great opportunities to enhance the design of the infrastructure, to increase employment or to better serve otherwise underserved members of the community.

There may be other challenges faced by the Procuring Authority and the broader government with respect to delivering infrastructure generally, and also delivering infrastructure using a PPP model. The PPP model can have negative public perceptions, and an understanding of the benefits of the model on a broader scale, particularly the benefits to end-users, should be communicated to the public. Negative publicity created by the media following a project specific failure may negatively impact a much wider public perception of PPPs, as a result of which the overall benefits of a specific project or of the PPP model in general may be overlooked.

Focus groups, comprising end-users and people living in or close to the area affected by the project, can be used for a qualitative assessment of expectations and feelings on the project's features and specific issues. Surveys are commonly used for gathering feedback from larger groups.

EXAMPLE

Design input and serving underserved groups

The I-495 Express Lane project in the USA highlights that public engagement with key stakeholders can deliver a better project for the community and for the project sponsor. Initial plans for the project included just one access point into the region's largest employment centre. After early feedback from major employers, elected officials and transit advocates, the project team changed the scope of the project to include three major entry and exit points to serve the busy commercial area. By proactively engaging stakeholders early, the parties were able to work collaboratively to develop a transportation solution that provided a better outcome

On the same project, the Procuring Authority mandated that the Project Company utilise 'Disadvantaged Business Enterprises' where possible, with $490 million contracted to small and disadvantaged businesses. At the time, it was the largest contribution in Virginia's history for such businesses for a single transportation project.

For more information, see the I-495 Express Lane Case Study.

EXAMPLE

Engaging with stakeholders on design particulars

The Zaragoza Tramway project in Spain highlights the benefit that all stakeholders can achieve by including the public in the decision-making process. In that project, for every tree that had to be removed for the construction of the tramway, two trees have been planted elsewhere, with the selection being carried out through a participative process, improving the overall outcome of a project.

For more information, see the Zaragoza Tramway Case Study.

EXAMPLE

Prioritised community engagement

Community engagement was prioritised on the Port of Miami Tunnel project in the USA, with local employment programmes during construction, and continuing work with local schools continuing throughout the project. This focus was seen as a key enabler of success, as construction of public projects was controversial at the time of financial close.

For more information, see the Port of Miami Tunnel Case Study.

M. Ensure ongoing transparent engagement with end-users, businesses and community stakeholders on all relevant issues

Transparency is one of the underlying principles of the relationship governing PPP procurement and delivery. It is particularly important during PPP contract management as it enables the Procuring Authority to obtain adequate information to manage the contract effectively.

Transparency is also an important component of wider stakeholder engagement and promoting public acceptance of a project. Disclosing information on the project's contract and performance helps to promote transparency and obtain acceptance of the PPP model and the project by the community, as well as allows for performance auditing of the PPP project and a wider PPP program.

Public stakeholders should be provided with an accurate understanding of what to expect both during construction and once service delivery commences. This will include an understanding of the positive impacts (including the scope of additional services to be provided and increased level of service), as well as the negative impacts (such as increased traffic noise, business disruptions and community relocation). This is particularly important during the construction phase when the community may be inconvenienced by the construction activities and stakeholders' support is particularly important.

One approach is to require the Project Company to set up a project website to introduce the project and provide regular updates on its development. A specific office for managing community enquiries can also be set up to manage inquiries.

There are several project specific issues that will be of interest to the public. They include:

- Workplace safety and environmental incidents
- Land acquisition and community relocation (this is particularly prevalent on linear projects, such as highways and rail projects)
- Public service requirements not being met in a publicly acceptable manner (e.g. tolls being too high and a toll road not being used)
- Reduced user charges (in a high performing PPP, costs have the potential to reduce over time and may lead to reduced user charges or government payments)
- High profit levels of the private partners (this may be detrimental from the public's point of view)

In some jurisdictions, the lack of transparency on the return on investment to the Project Company's equity investors creates negative publicity surrounding not only a specific project, but the PPP model in general. This leads to a lack of confidence in achieving value for money from the Procuring Authority's point of view and a public opposition to the use of PPP projects. In this sense, transparency is very important for and highly correlated to effective stakeholder management.

The Procuring Authority should also publish performance statistics, reviews, contract renegotiations and any other changes or issues that are relevant to the public. It also needs to consider what information will be made publicly available and what may be the subject of confidentiality obligations owed by the Procuring Authority.

The PPP contract typically defines the requirements for information sharing between the Project Company and Procuring Authority and public disclosure requirements, as well as any exceptions from disclosure. Disclosure of the contract may be limited to protect the legitimate interests of the Project Company by keeping commercial information confidential, as well as to recognise the need for the Procuring Authority to protect its position for future negotiation.

While it may be in the Procuring Authority's interest to aim for as much transparency as possible in order to protect public interests and ensure value for money, it is always challenging to achieve an optimum balance between the level of detail desired and the limitations imposed by confidentiality on commercially sensitive information required by the private sector.

The reference tool does not cover specific disclosure requirements of project information by the Procuring Authority and associated requirements as defined by applicable laws, codes of practice and standard national guidance that may exists in each jurisdiction. The relevant laws, regulations and guides typically set out specific and well-defined requirements with regard to both pre-procurement and post-procurement disclosure responsibilities placed upon the Procuring Authority.

N. Define the role of the Project Company in the management of end-users, businesses and community stakeholders

Both the Procuring Authority and Project Company can have responsibilities to engage with the community on the current status of the project and any issues affecting end-users and local community. It is important that the communication from both sides is well-coordinated and consistent.

It may be difficult however for the Procuring Authority to properly incentivise the Project Company to undertake the same level of community engagement as what the Procuring Authority desires. Where the Project Company is primarily driven by profit objectves, undertaking additional community engagement where there is no associated payment mechanism may not sufficiently incentivise the Project Company.

One method for addressing this issue is to be very prescriptive about what is required in the PPP contract. This could involve setting specific requirements for staffing or meeting frequencies with community stakehodlers.

As is detailed in Section 3.2 (Performance monitoring), the Procuring Authority should closely monitor the Project Company's actions when the Project Company is required to enagage with community stakeholders. If not done correctly, the issue will not just be a Project Company issue, but will also affect the Procuring Authority irrespective of where the obligations and the risks are allocated.

EXAMPLE

Zaragoza Tramway

During the construction phase of the Zaragoza Tramway project in Spain, the Project Company employed a communications director, and information offices were set up so any individual or business could seek information about the project or any issues arising regarding the construction. During operations, there was a customer service office to respond to complaints and questions from members of the public. This was seen as a useful way of engaging with users, as well as an opportunity to gather feedback to improve the service itself.

For more details, see the Zaragoza Tramway Case Study.

EXAMPLE

Prescriptive contractual requirements

The Project Company in one of the case studies was required under the PPP contract to hire a certain number of staff dedicted to community engagement and to hire staff with defined qualifications.

O. Consider each relevant community group, as they may have different interests and desired outcomes

Different community groups have different interests and it may be beneficial to adopt specific communication strategies for each relevant group. For example, end-users should be given the chance to give feedback on the quality and effectiveness of the service being provided; whereas residential communities may be concerned about the noise, and businesses concerned about business disruption caused by construction or maintenance works.

Groups meetings can be scheduled with key stakeholders and can be determined and sub-divided by relevant interests to be responsive to their needs.

EXAMPLE

Differentiating interest groups

The Procuring Authority and the Project Company in one of the case studies took a coordinated approach to community engagement and set up key consultative forums. The consultative forums were referred to as the 'Business Reference Group' and the 'Community Reference Group'. The former was made up of business representatives, with the latter being made up of community representatives. The business and community forums are organised by the Project Company, which then reported back to the Procuring Authority.

3.3.5 Guidance: other government agencies

P. Consider the level of involvement required from other government agencies

Due to the nature of PPP transactions, they involve a variety of government agencies, other than the Procuring Authority who will also play a role. Some of those other stakeholders can include:

- Finance ministries. Finance ministries will typically be required to provide approvals (with regard to additional funding, major scope changes, and contingent government liabilities) and may have reporting requirements.
- Planning bodies. Planning permission is a major issue for many projects. Planning permission is also relevant in understanding what future development may occur in an area. For example, if there are residential or commercial developments planned, which may have an impact on the project.
- Health and safety or environmental regulators. These bodies will often have the power to halt work on a project if they are not satisfied with the procedures being followed, and/or if there is an instance of non-compliance with the relevant regulation and are therefore critical stakeholders.
- PPP units. Central PPP units also play an important role in the overall success of the project. Resources and information provided by central PPP units can be invaluable for sharing lessons learned and improving project outcomes. This can be from a central PPP unit within the regional or national government, or a central body which has been set up to assist with projects in certain sectors. The role of PPP units with respect to contract management team training is detailed in Section 2.2 (Contract management team training).
- Interfacing project operators. Stakeholder engagement is also required on projects which interface with other projects under the jurisdiction of a different Procuring Authority. Interfaces between different sectors or sub-sectors are very important. For example, a rail project may interface with power lines, other utilities, a highway or a bus rapid transit project.
- Local or regional authorities affected by the project. A high-profile project will be of broader interest to the government, as it has the potential to affect the reputation of the administration in power at the time.

The Procuring Authority should carefully consider what information needs to be passed on to other government departments, such as a ministry of finance or other regulators. As a range of reports will be produced during both the construction and operations phases, there needs to be an assessment made of what exactly the Procuring Authority should report to the relevant government agency. Where there are significant changes made to a project (e.g. significant scope changes) approval is likely to be needed from a department such as the ministry of finance. This emphasises how important it is to consider what information needs to be shared with these departments. Scope changes are detailed in Section 3.5 (Claims).

It is also important for the Procuring Authority to assist these bodies by providing relevant project data to inform future infrastructure development. The combination of information from multiple sources is part of how these organisations, network groups and sector bodies are able to add value and improve the use of PPPs in that particular region. A Procuring Authority should maintain good relationships with these bodies to allow it to have continuing access to such resources. All markets, irrespective of whether they are mature or developing, have scope to improve significantly the strategy and the approach to understanding the value of data, including collecting and sharing it and making smart and effective use of it.

EXAMPLE

Multiple government agencies

On the Port of Miami Tunnel project in the USA, funds were provided by federal, state, county and city sources, with the City of Miami also granting land access. The promise of ongoing funding to the Procuring Authority is particularly important given the decision not to impose tolls, as this increased the amount of money required from government. The Procuring Authority executed a funding agreement with the city and county, but these authorities had no direct oversight over the project. To assist in the management of the project, weekly meetings were held which included the Procuring Authority, the Project Company and the construction contractor, as well as representatives from city and county governments.

For more information, see the Port of Miami Tunnel Case Study.

Q. Set up effective governance structures to manage the relationships with other relevant government agencies

Coordination between different levels of government is an important aspect of contract management, which is amplified where financing is being provided by multiple bodies.

Appropriate institutional and governance frameworks should be established to enhance the flow of information between government agencies. Challenges can arise where there is overlap in the mandate of different government agencies which needs to be managed.

One method of achieving this is to set up project advisory boards which are made up of representatives from different government agencies.

EXAMPLE

Project advisory board

An advisory board was set up in one of the case studies to provide assurance, strategic oversight and advice in relation to the project to the Minister of the Procuring Authority. It has an independent chair, two additional independent members and representatives from the ministry of finance, the executive office, as well as other relevant ministries. The advisory board meets every month.

As well as providing assurance, oversight and advice to the Minister, it also acts as a forum for better communication and collaboration across the different relevant government bodies with respect to the project.

R. Collaborate with the Project Company to work with other government agencies, where appropriate

Challenges can arise due to differences in regulation between levels of government, such as between the local authority, state/provincial level and national level, and also because different aspects of a project are regulated by different government agencies. If agreements are not reached with relevant local authorities on projects procured (e.g. by a national government before financial close) delays to approvals and potentially additional taxes may be imposed, as has been the case in several jurisdictions.

EXAMPLE

Construction permits

During construction of the Brabo 1 Light Rail project in Belgium, an issue occurred where the Project Company's construction permit was revoked because of public objections to the proposed developments. A new permit was, however, issued a few months later. Together with the Project Company, the Procuring Authority worked as a partner to resolve the issue.

For more information, see the Brabo 1 Light Rail Case Study.

It may be appropriate in these circumstances for the Procuring Authority to work with the Project Company in engaging with other government agencies, particularly where the Procuring Authority has a stronger relationship with those other government agencies. Working with other government agencies during key transition phases is detailed in Section 3.1 (Transitions).

S. Plan early for managing other government or quasi-government agencies that the Procuring Authority does not have influence over

There may be government agencies or quasi-government agencies that the Procuring Authority does not have a strong relationship with. In these circumstances, where certain project milestones rely on the input from those other government agencies, the Procuring Authority should plan early, and enter into agreements with those other government agencies to ensure there are no disruptions to the project.

EXAMPLE

Interfacing projects

The importance of managing interfaces with other projects was highlighted in the Intercity Express Programme project in the UK, where the success of the project depended on interactions with the delivery and electrification of track infrastructure. This was done by Network Rail, which is an arm's-length public body and therefore not part of the Department for Transport itself.

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

EXAMPLE

Land acquisition in India

In India, the issue of land acquisition led to delays and disputes on numerous highways projects. Land management is a state subject under the responsibility of the Competent Authority for Land Acquisition (CALA). The National Highways Authority of India (NHAI), which is the Procuring Authority on many toll roads, has no direct control over CALA and is dependent upon the state governments and its policies. To address this, NHAI has regional offices in charge of the respective states, and they coordinate with the relevant departments in each state. In order to facilitate land acquisition, the NHAI enters into a state support agreement with the concerned state. The NHAI also employs retired officials from the state governments to assist with understanding land regulations.

3.4 Information Management

PPP projects generate a large amount of information and data, which must be managed by the Project Company and Procuring Authority throughout the project life. The Project Company is typically required to submit periodic performance reports with detailed reporting on performance failures, availability reports, safety reports, information on public policy issues, etc.

Managing information well ensures that the Procuring Authority has a clear understanding of how the Project Company is performing and the quality of the service provided. It is also directly relevant to performance monitoring (including monitoring of KPIs), detailed in Section 3.2 (Performance monitoring), and effective management of disagreements and disputes, detailed in Chapter 5 (Disputes).

Document control is an essential part of contract management. A number of projects were found to suffer from poor document and data control, which was the result of two factors:

- The volume of documents and data was underestimated when the contract management plan was formulated
- An inability to comply with the information management strategy in place

Challenges can arise when the parties do not recognise the importance of the information and data management strategy from the outset, particularly in the case of large and complex PPPs. Robust and well-structured document and data control ensures the continuity of knowledge throughout the duration of the contract. It also provides opportunities for knowledge sharing within the team and between the relevant parties. Continuity of knowledge among contract management teams is key to successful contract management.

Poor information management can lead to:

- Disagreements and disputes with respect to claims or scope changes, where neither party is fully aware of what the underlying facts are
- Non-compliance with intragovernmental reporting requirements
- Poor performance monitoring
- Poor public transparency with respect to the performance of the Project Company under a PPP contract
- Repetition of mistakes made on other projects because the remedies were not properly recorded

EXAMPLE

Document control during transitions

The Procuring Authority on the Brabo I Light Rail project in Belgium experienced a challenging transition between construction and operations, made more difficult by inadequate document control. A better information management system was needed to help with continuity of knowledge, and to access data and information that was created during construction.

For more information, see the Brabo I Light Rail Case Study.

SECTION STRUCTURE

This section provides guidance on information management. The key elements of successful information management are summarised below and detailed in Subsection 3.4.1 (Guidance):

A. Understand the scope of the data to be collected and maintained as part of the project

B. Develop an information management system that works for the Procuring Authority and the Project Company

C. Where possible, use similar information management systems and software across multiple projects

D. Agree the level of detail required from the Project Company early, to set expectations around the form of information required

3.4.1 Guidance

A. Understand the scope of the data to be collected and maintained as part of the project

The Procuring Authority needs to understand the size and requirements of the project from the outset so that it understands and can track the scope of the data to be managed. This will include having a thorough understanding of what is required under the PPP contract as well as what is required internally from a good record keeping point of view. Most of the information will be provided by the Project Company as part of its obligations under the PPP contract; however, the Procuring Authority should verify this information on a regular basis (as necessary) to ensure that it is accurate and consistent and keep internal records. For example, in relation to claims or other communications with the Project Company. The lenders to the project may also be required to report to the Procuring Authority in some circumstances.

B. Develop an information management system that works for the Procuring Authority and the Project Company

In many jurisdictions, Procuring Authorities define in the PPP contract that the Project Company must use a shared internet-based information management system for the duration of the PPP contract that will be accessible to both parties. Some Procuring Authorities prescribe the type of software to be used to ensure consistency with its own internal information management systems. The parties will also maintain their own internal information management system.

The Procuring Authority should carry out the following when setting up its information management systems:

- Involve all parties in setting up the information management strategy from the beginning to ensure compatibility
- Agree with the Project Company on what information needs to be collected and retained
- Agree with the Project Company to a common platform for storing and sharing documents, such as updated contractual documentation, annual reports, etc
- Identify the project needs and information management strategy before exploring the options for information management systems. Depending on the information management strategy and agreed processes, some databases work better than others as they have advantages and disadvantages based on their use. In some cases, a conventional shared drive will be more suitable than a database
- Use a secure electronic information management system to keep records of all key documents
- Ensure the Procuring Authority has access to the relevant IT tools deployed by the Project Company throughout the life of the PPP contract, including helpdesk, performance monitoring systems, etc.

> **EXAMPLE**
>
> **Incompatible information management systems**
>
> On the Gautrain Rapid Rail Link project in South Africa, data and information management systems were stipulated in the contract. These systems turned out to be incompatible with the Project Company's systems. The Project Company had to convert their document and information management system to be compatible with the Procuring Authority.
>
> ***For more information, see Gautrain Rapid Rail Link Case Study.***

C. Where possible, use similar information management systems and software across multiple projects

Where a Procuring Authority has systems in place for their portfolio of assets, it is more efficient to build the information management strategy to fit with their existing systems. The decision to set up a new information management system or database should be carefully approached and looked at as a last resort. Implementing new systems into an organisation is a time consuming and costly endeavour that should not be considered unless the existing systems are inadequate.

The Procuring Authority should adopt a single piece of software where possible, which it is already familiar with, to be used between the parties for all communication and record keeping purposes. For example, in one of the case studies, a dedicated program called 'Teambinder' was used successfully as a communication and record management tool and is also consistently used on other projects procured by the Procuring Authority.

D. Agree the level of detail required from the Project Company early, to set expectations around the form of information required

The contractual requirements of the information management system do not always specify the level of detail required, which is important from an operational point of view. This can be problematic when it is not clear what is required. The Procuring Authority should agree what is required from the Project Company from the outset of each project phase, as the level of detail may not be prescribed in the PPP contract.

3.5 Claims

A PPP contract typically gives the Project Company the right to claim compensation and/or time relief for certain defined events. Typically, these involve situations where the Project Company has incurred unanticipated costs and/or delays, due to acts or omissions of the Procuring Authority or a third party, or due to *force majeure* events.

A PPP contract typically also contains provisions where the Procuring Authority has a right to make a claim against the Project Company. Section 3.2 (Performance monitoring) details the arrangements governing the Project Company's performance and the application of payment deductions for non-performance, and Chapter 7 (Default and termination) details Project Company default. In contrast, this section 3.5 deals with claims made by the Project Company.

Claims can involve significant amounts of money. If they are not managed well they can lead to higher costs for the Procuring Authority and could impact on the value for money forecast at financial close. Additionally, whether the claims made by the Project Company are justified or have merit is not always clear at the outset of a claim, so they can be contentious and have the potential to lead to disputes. Management of disputes is detailed in Chapter 5 (Disputes).

It is important for Procuring Authorities to set up robust internal procedures for managing claims and scope changes as the right of Project Companies to make claims is fundamental to the risk allocation of PPP contracts and how they operate.

This section considers claims irrespective of the specific mechanism used to process the claim. For example, specific claim mechanisms and procedures are typically defined in common law PPP contracts. However, civil law PPP contracts may rely more heavily on general law principles, particularly with respect to force majeure claims or material adverse action by government authorities. Some civil law PPP contracts also rely on economic rebalancing procedures, detailed in Chapter 4 (Renegotiation). The specific mechanisms for making claims are not detailed in this section as they vary substantially across jurisdictions.

Although this section deals with various types of claims made by Project Companies, it particularly focuses on claims arising from scope changes, which are quite common. Scope changes can be slightly different to other types of claims and can also be initiated by either party. Scope changes may also be more complex as they have the potential to affect the risk allocation agreed in the PPP contract.

A more serious claim made by a Project Company could result from a Procuring Authority breach of the PPP contract giving rise to a Procuring Authority default and termination rights. There are also circumstances where the persistence of certain claims over a prolonged period (e.g. a prolonged *force majeure* event) will ultimately lead to termination rights. Both of these topics are detailed in Chapter 7 (Default and termination).

SECTION STRUCTURE

This section provides a background to managing claims in Subsection 3.5.1 (Background) and provides guidance on managing claims. The key elements to successfully managing claims are summarised below and detailed in Subsection 3.5.2 (Guidance).

A. Understand the Project Company's rights to claim under the PPP contract and ensure the team is adequately resourced to assess claims

B. Monitor the risk of potential claims to mitigate their occurrence and prepare early for their receipt

C. When assessing scope changes, aim to retain the risk allocation agreed at financial close and ensure value for money

D. Understand the claim and scope change procedures set out in the PPP contract and ensure the Procuring Authority complies with the procedures

E. Process claims and scope changes quickly to avoid them turning into disputes or having other adverse impacts on the project

F. Work with other government agencies to mitigate the risk of claims arising and to assist in the processing of claims

G. Introduce polices to limit early and frequent scope changes

H. Be aware of the interests and requirements of the Project Company's lenders in the processing of claims

3.5.1 Background

This background provides a summary of some common types of claims that can be made by a Project Company under a PPP contract, noting the ability to claim will depend on the specific PPP contract and the underlying legal framework, including the risk allocation agreed between the parties. For guidance on typical risk allocation arrangements between the Procuring Authority and the Project Company see the GI Hub's PPP Risk Allocation Tool[1]. The purpose of this background information is to set the context of typical types of claims and some common types of claims procedures. A selection of common types of claims are outlined below and are detailed in this subsection:

- Claims for the Procuring Authority's breach of contract
- Material Adverse Government Action (MAGA)
- Change in law or relief from sanctions
- *Force majeure*
- Scope change

Claims for the Procuring Authority's breach of contract

An issue of Procuring Authority non-compliance or breach of the PPP contract which negatively affects the Project Company's ability to deliver its works or services will typically lead to a claim for additional time and costs. When a breach of a contract is defined as a default, then it could give also rise to termination rights. For example, failure to provide land or access to a site on time, failure to make a payment on time, failure to execute third party agreements on time, failure to secure relevant approvals, or failure to deliver interfacing infrastructure. Other actions that negatively affect the Project Company's ability to deliver its works or services can also lead to a right to claim.

Major Adverse Government Action (MAGA)

There are several risks in a PPP project that have the potential to significantly impact a project but are not under the direct control of either party. For example, actions or inactions of a government agency (other than the Procuring Authority) that have a material adverse impact on the project and the Project Company. It is typical that the Project Company will want the Procuring Authority to retain this risk as the Procuring Authority is a government agency and has a greater degree of control over such events. Several jurisdictions describe this type of event specifically as a 'Material Adverse Government Action' or 'MAGA' and PPP contracts generally include provisions allowing the Project Company to seek relief with respect to the materialisation of a MAGA event. Other jurisdictions may have other mechanisms but will typically allow the Project Company to claim relief.

Change in law or relief from sanctions

A change in law or a sanction can also have an impact on the Project Company as the Project Company is required to adhere to the relevant rules and regulations of the jurisdiction in which it operates. Which party is required to pay any additional costs related to a change in law will depend on the risk allocation agreed in the PPP contract. The PPP contract will typically set out the circumstances in which a party can seek relief as a result of specific changes in law, and which changes in law will not carry with them any entitlement to relief. There may also be potential for the Project Company to benefit from a change in law, meaning that any compensation payments for change in law can flow in either direction. The 2017 version of the World Bank's Guidance on PPP Contractual Provisions[2] provides detailed commentary on different types of change in law regimes.

Force majeure

The phrase *force majeure* typically refers to events that are outside of the control of the parties, could not have been anticipated and make it impossible for a party to comply with the PPP contract. *Force majeure* provisions are common in PPPs and what constitutes a *force majeure* event may be set out in the relevant PPP contract or in the relevant law (particularly in civil law jurisdictions). The occurrence of *force majeure* events are commonly approached in a manner which allows the parties to be relieved of their contractual obligations, as these events are unforeseen and out of the control of either party. The risk of an event's occurrence is often shared between the parties. *Force majeure* events are rare. The data analysis indicates that 7% of projects suffered a *force majeure* event and most claims of *force majeure* were a last resort.

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1 Available at http://ppp-risk.gihub.org.

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

A Project Company is typically required to have insurance to cover certain *force majeure* events which are insurable. Insurance will be in place as a method to transfer the risk of the insurable force majeure to a third party insurer. The Project Company will typically pay any required insurance premium. The Procuring Authority should be aware of any insurance held by the Project Company or that should be held by the Project Company. The Procuring Authority should be aware of the effect of an event becoming uninsurable, where the Procuring Authority may need to effectively self-insure.

Scope change

There are typically two key types of scope changes that may require different approaches from the Procuring Authority to manage:

- Minor scope changes. Minor scope changes should be manageable within the scope change provisions of a PPP contract without having a significant impact on the agreed risk allocation.
- Significant scope changes. A significant proposed scope change may be more complex to assess and to implement. Procuring Authorities should be aware that the contract may impose limits on the ability of either party to initiate changes of this nature within the scope change mechanism set out in the PPP contract. Renegotiation may be the appropriate mechanism to use where such changes are required, but termination may also need to be considered. Significant scope change will also have the potential to affect the risk allocation agreed in the PPP contract. Renegotiation is detailed in Chapter 4 (Renegotiation) and termination is detailed in Chapter 7 (Default and termination).

Typically, either the Procuring Authority or the Project Company may request a scope change. The Procuring Authority will often have the right to direct a minor scope change. Such a change will be subject to agreement on time and costs and this will affect how the process is managed by the Procuring Authority. The specific procedure will depend on the PPP contract and the underlying legal framework.

EXAMPLE

Accelerated airport expansion

The Queen Alia International Airport Expansion project in Jordan experienced a significant scope change when it became evident that passenger numbers were higher than had been predicted. The original plan had been to expand the airport in two stages, however it became clear that the first stage of expansion would not be sufficient to account for the passenger growth. While construction was continuing, both parties agreed that it would be more efficient to change the design so the expanded terminal was able to handle higher volumes than had been originally estimated. This was a situation where a clear benefit was visible and, with the extra revenue of higher passenger numbers, the negotiation was relatively simple. The incentives to both sides were aligned and a superior service to the users was achieved.

For more information, see the Queen Alia International Airport Expansion Case Study.

3.5.2 Guidance

The following guidance outlines the key issues that should be considered when managing claims made by a Project Company in relation to a PPP contract.

A. Understand the Project Company's rights to claim under the PPP contract and ensure the team is adequately resourced to assess claims in a timely manner

The Procuring Authority should be equipped to manage claims. It should also have a good understanding of the contract mechanisms applicable to the claim and the fundamental risk allocation agreed between the parties in the PPP contract. When a claim is received, the Procuring Authority should act quickly to first assess the merits of the claim and, if the claim has merit, the likely implications of approving the claim (including the financial implications).

How project risks are allocated between the parties is normally carefully developed, negotiated and agreed in the PPP contract and this allocation should be maintained. Identifying the underlying cause of the claim will allow the Procuring Authority to assess its merit. To be able to properly assess claims the Procuring Authority should be aware of the circumstances in which the Project Company is entitled to make a claim under the PPP contract (or under the applicable law) so that claims can quickly be assessed on their merit. Some examples of when the Project Company may be entitled to make a claim are detailed in Subsection 3.5.1 (Background).

It is also worth considering the role of the Project Company's key contractors, from whom many of the Project Company's claims will likely originate.

The merits of a claim may be encompassed within complex legal documentation. Claims may also be subject to relevant threshold requirements (such as that only material claims can be made) or there may be caps in terms of a maximum amount payable with respect to a claim. These legal boundaries, thresholds and caps also need to be considered. It is important that legal advice is sought at an early stage with respect to claims where the risk allocation is not clear to the contract management team. For example, challenges can arise when the Project Company makes a claim regarding a shared risk or in circumstances where the relevant risk allocation is understood differently by the parties.

The likely consequences of approving the relevant claim should be assessed. This will include an assessment of the financial and timing consequences of approving the claim, including any mitigation measures that can be taken to minimise the cost or time implications. Steps proposed to be undertaken by the Project Company to mitigate delays and costs to the project should be well understood and documented prior to approving a claim. Relevant technical and financial specialists will need to be involved in this process.

The assessment of a claim will be substantially dependent upon the level of information available. It is common for contracts to specify a minimum level of information to be provided by the Project Company when making claims. However, more information may be required. In addition to using its own records, the Procuring Authority should be aware of the rights it typically has under a PPP contract to request more information from the Project Company, or indirectly from the Project Company's contractors. Even if no such obligation exists, it is difficult for the Project Company to argue that the Procuring Authority should not be given access to additional information.

In practice, even where the merit and quantum of a claim is relatively clear, that does not mean that the resolution of the matter will always be straightforward, as many other factors may come into play such as the balance of power between the parties and the existence of other claims and objectives.

The assessment of the claim and its consequences should consider the availability of any relevant insurance either held by the Procuring Authority, by the Project Company or by a third party. If a claim involves a risk that is covered by an insurance policy, the insurers should be involved in the process as early as possible.

Claims should only progress if the risk was allocated to the Procuring Authority under the PPP contract, to ensure the allocation of risk agreed between the parties is not altered.

B. Monitor the risk of potential claims to mitigate their occurrence and prepare early for their receipt

A thorough understanding of the PPP contract is essential for mitigating the risk of claims and preparing for their receipt where a claim may be inevitable. For this it is common for the Procuring Authority to establish a risk register which should provide a continuous assessment of the relevant risks in terms of their likelihood, severity and potential mitigation measures available.

The risk register should be revisited on a regular basis throughout the life of the project as the risk environment will likely change given the long timeframes involved. This involves assessing and reassessing, on an ongoing basis, both the likelihood and severity of impact should a risk materialise and assessing whether there are any actions that the Procuring Authority can take to prevent or mitigate those risks, given any new information that has been made available.

Monitoring project risks will mean the Procuring Authority is aware of potential claims and can start considering them and planning for them before they are received from the Project Company.

The Procuring Authority should consider the implications of changes in technology over the contract duration. For example, what happens when certain lifecycle items become obsolete due to technology changes or changes to services due to technological advancement? Changes in law can also affect the risk profile of a project. It is unusual for changes in law to happen overnight, perhaps with the exception of international sanctions. Where the prospect of a change in law or technology change appears reasonably likely, it is sensible for the Procuring Authority and the Project Company to discuss in advance how those changes will be addressed.

C. When assessing scope changes, aim to retain the risk allocation agreed at financial close and ensure value for money

A key consideration that specifically relates to scope changes is the potential impact that a scope change will have on the risk allocation agreed between the parties. This is of particular relevance where the scope change is significant and the terms of the PPP contract are required to be amended. Renegotiation is detailed in Chapter 4 (Renegotiation). As noted above, the allocation of project risks between parties is normally carefully developed, negotiated and agreed in the PPP contract and this allocation should be maintained through any scope changes.

Given the long-term nature of PPP contracts, it is not uncommon that there will be a need for a scope change at some stage. This can arise through changing priorities of the Procuring Authority, advancements in technology, required design enhancements or through broader economic changes in the country or region (including changes in demand). Scope changes can also occur as the result of inadequacies in the original scope or due to an opportunity to optimise design or construction works or services (such as costs savings available due to changed market conditions for steel or concrete).

Typically, each party has the right to initiate a scope change request, and an agreed scope change procedure typically prescribes the step-by-step arrangements for managing the requested scope changes and associated timelines for the parties to submit proposals and provide approvals. It is also not uncommon for the Procuring Authority to have the right to instruct an immediate minor scope change with pricing and time to be agreed at a later stage. The specific procedure will depend on the PPP contract and the underlying legal framework and should be well known to the Procuring Authority.

Where the Project Company has initiated a scope change request, the Procuring Authority will need to carefully analyse the Project Company's rationale for the proposed scope change and all the implications of the Project Company's request, including whether the evidence submitted to document the cost, time and risk implications is valid and robust and satisfies value for money tests.

Where the Procuring Authority has initiated a scope change, the Procuring Authority should have undertaken an initial assessment and have an understanding of the scope of the proposed change, its cost and time implications, and the overall impact on the risk profile, before the scope change request is passed to the Project Company.

Irrespective of whether a scope change is initiated by the Procuring Authority or the Project Company, a full assessment of its impacts will need to be undertaken by the Procuring Authority. There will generally be a cost and/or time impacts (although not always, and such cost/time implications may be positive for the Procuring Authority in cases where the scope is reduced). There may also be an overall impact on the risk profile. This impact assessment should be completed before any negotiation over the terms of the scope change begins and should include evaluations of the financial, technical, contractual and program implications of any scope change.

Any potential scope change assessment should consider in full the implications on: scope of works; cost implications; allocation of risk; impacts on the existing risk profile; changes to the existing capital expenditure; operational expenditure and lifecycle budgets; time implications; impacts on the payment mechanism and performance standards; impacts on the existing security packages (e.g. performance bonds and guarantees) provided by the Project Company, liability caps; and any potential impact on the value for money of the project.

Any added value that could be generated for the project as a result of a potential scope change should also be explored.

To assist its assessment, the Procuring Authority may be able to implement a form of benchmarking or market testing to ensure it is still receiving value for money for the changed scope. This is typically not a simple process, particularly given that alternative contractors are likely to charge a premium for taking on a project delivered by another contractor, and given that the intervention of another contractor may adversely affect the warranties and indemnities provided by the Project Company. In some jurisdictions, a schedule of rates will be included in the contract for certain scope changes, which can also be used in assessing scope changes.

EXAMPLE

Use of benchmarking

On the Central Berkshire Waste project in the UK some waste and haulage services were subject to benchmarking. The contractor would compare its costs with the market price of equivalent services. The price would then be adjusted accordingly, unless the Procuring Authority chose to proceed to market testing, which is effectively re-tendering of the contractor's scope. Any subsequent increase or decrease in the cost of the works or service would then be reflected by an adjustment to the unitary payment available to the Project Company. While benchmarking may be carried out by the Project Company, it is essentially a joint exercise, as the Procuring Authority must be satisfied that it is receiving value for money. A team comprising representatives from both parties can be set up to oversee this type of benchmarking exercise.

For more information, see the Central Berkshire Waste Case Study.

The allocation of risk associated with a material scope change can also be the subject of prolonged commercial negotiations and the Procuring Authority may need to hire external advisors for significant or complex scope changes. Questions over what constitutes a change and what falls within the scope of the Project Company's pre-existing obligations also have the potential to lead to disagreements.

D. Understand the claim and scope change procedures set out in the PPP contract and ensure the Procuring Authority complies with the procedures

The Procuring Authority should have full visibility on its procedural obligations with respect to claims and scope changes and the timelines for performing these obligations as agreed in the PPP contract. When a claim is received by the Procuring Authority it is important to be aware of the agreed procedures to ensure compliance.

The Procuring Authority should also be clear which activities are on the critical path and which are conditions precedent for other major activities as the timelines will typically be integrated into the Project Company's program. Failure to respond to claims according to the agreed procedures may render the Procuring Authority in breach of the PPP contract and liable for additional claims. This is particularly the case where there are deeming provisions (where a claim may be deemed to be accepted when no response has been received from the Procuring Authority within a defined time).

It is advisable for Procuring Authorities to establish efficient internal procedures to ensure that claims are processed in a timely manner as required by the PPP contract. In many instances, template documentation can be prepared to assist with the initial stages of responding to common claims, which can be created with the assistance of legal advice.

The research indicates that it is not uncommon for scope change procedures to be overlooked or not followed properly. This can result in significant problems, including increased tension in the relationship with the Project Company and increased risk of disagreements in the absence of a clear process.

Notwithstanding the need to follow the procedures set out in the PPP contract, there are times when these procedures may turn out to be unworkable, in particular where time periods to generate information, review and respond may be impracticable. For example, in a situation where additional external resources need to be mobilised to assess matters. In these circumstances, the risk of increased tension between the parties is also higher. A solution to this issue is for the parties to formally waive their strict contractual requirements and to agree to a less formal and more workable processes. Waiving rights under a contract should only be undertaken after receiving legal advice, to ensure an appropriate waiver is effected (i.e. that the Procuring Authority is waiving only what it is intending to waive and not waiving the Project Company's obligations to comply with the relevant procedure in the future). An amendment to the PPP contract may also be appropriate. Renegotiation is detailed in Chapter 4 (Renegotiation).

One option for dealing with scope changes which can smooth their implementation is to carry out a 'soft' opening. A soft opening involves issuing a scope change notice informally, allowing the change to be considered a number of weeks in advance of issuing a formal notice. Care needs to be taken to avoid inadvertently triggering the formal scope change mechanism. Unless express contractual provisions exist permitting a 'soft' opening, legal advice should be sought in relation to this process.

EXAMPLE

Taking a flexible approach to variations

The Central Berkshire Waste project in the UK introduced a system whereby one party submits an informal notice of change one month before the formal notice is issued. This gives each party the opportunity to review and adapt to its implementation before it is formalised.

On the InterCity Express Programme project, also in the UK, challenges from associated infrastructure works meant that the Procuring Authority had to take a flexible approach to dealing with variations.

For more information, see the Central Berkshire Waste and InterCity Express Programme Case Studies.

E. Process claims and scope changes quickly to avoid them turning into disputes or having other adverse impacts on the project

Once the Procuring Authority has assessed the merits of a claim and it has satisfied itself that the claim has merits, it should aim to accept the claim as quickly as possible. Whenever possible, the relationship between the parties should not be affected by a drawn-out claim, nor should the parties spend unnecessary amounts of money in disagreement or dispute about a claim that should be accepted by the Procuring Authority. Management of disputes is detailed in Chapter 5 (Disputes).

The management of scope changes needs to be undertaken efficiently to minimise adverse impacts on the project while at the same time preserving value for money. It is important to classify scope changes and develop a framework to ensure minor changes can be dealt with efficiently while significant changes (e.g. addition of a new airport runway) undergo a robust review to ensure value for money.

Where the parties cannot agree to the merits of a claim or the consequences (including compensation payable or additional time) the parties should work together to come to a solution.

EXAMPLE

Working in partnership to avoid disputes

The Brabo I Light Rail project in Belgium was connected to the wider network of Antwerp, resulting in increased usage and maintenance requirements of some sections of the project. The Project Company and Procuring Authority worked together to estimate the additional costs, avoiding any disagreements.

For more information, see the Brabo I Light Rail Case Study.

It is also important that the Procuring Authority understands the impact that cash flow risk may have on the Project Company's or its contractor's behaviour in dealing with claims. From a Project Company's perspective, there is a strong preference for having claims assessed as quickly as possible, even at the risk that only part of its claim is successful. Conversely, where a claims process is delayed (and particularly where similar claims continue to be made and not assessed) the Project Company may become entrenched in its position. This highlights the importance of dealing with claims and opening a direct line of communication as quickly as possible. Project Company cash flow risks are detailed in Chapter 6 (Insolvency), which details guidance on the financial status of Project Companies prior to insolvency.

Having effective governance structures in place to process and approve claims quickly will be key. Guidance on governance is detailed in Section 2.1 (Contract management team set-up) and Section 3.3 (Performance monitoring) (with respect to other government stakeholders that are not the Procuring Authority, such as a ministry of finance or equivalent government agency).

F. Work with other government agencies to mitigate the risk of claims arising and to assist in the timely processing of claims

The Procuring Authority should work with other government agencies to mitigate against the occurrence of a MAGA event, as detailed in Subsection 3.5.1 (Background). This will require closely managing relationships with other government agencies.

There can also be a threshold value for scope changes which the Procuring Authority can implement without seeking approval from the relevant authority in the government. For example, in the Philippines that threshold is 10% of the total capital value. For any scope changes below the threshold value, the Procuring Authority is required to report the scope change to the financing authority but no approval is required from the financing authority. Approval is required for any scope changes above the threshold. Other jurisdictions may define a material scope change which requires approval from the relevant ministry of finance or equivalent agency.

Managing relationships with other government agencies is one of the topics detailed in Section 3.3 (Stakeholder management).

The procurement regulations and other applicable laws of a particular jurisdiction may also impact on what the Procuring Authority can do in terms of providing additional funding to compensate for a claim made by the Project Company. For example, the concept of 'state aid' in the EU restricts what a public sector body can provide to a private organisation such as a Project Company and this has to be assessed carefully.

Where the settlement of a claim or approval of a scope change requires additional funding, securing the budget for implementing the scope change should be considered at an early stage of the process. An inability to settle a claim quickly can mean that the claim inadvertently progresses to a dispute. This risk should be mitigated by properly communicating with and working other relevant government agencies, including a ministry of finance or equivalent agency.

G. Introduce polices to limit early and frequent scope changes

The Procuring Authority should aim to limit the introduction of too many scope changes soon after financial close, as this might affect value for money forecast at financial close and alter the risk allocation agreed in the PPP contract. For example, such actions may be symptomatic of shortcomings in the design, such as its incompleteness.

The key issue associated with significant scope changes is that it is no longer obvious that the Project Company offers the most cost-effective solution for the scope change in the absence of competition. This is because the scope change may be being processed through what is an agreement negotiated bilaterally between the parties, without competition, and the project's value for money becomes less clear. Some jurisdictions require a freeze on design changes made after financial close for an initial duration.

Minor changes during the course of operations are considered normal, as they may entail little or no costs cost but can capture changes in circumstances during the contract's lifecycle.

H. Be aware of the interests and requirements of the Project Company's lenders in the processing of claims

Significant claims and scope changes are of key concern to project lenders and the Project Company's loan documents will likely contain restrictions on what scope changes are permitted and when lender consent is required. The threshold for when consent is required is typically low. The lenders want to be involved where there is a significant change to the scope and risk profile of the project, whether or not lenders are required to finance the scope change. Any change to the risk profile agreed at financial close may have an impact on the cash available to pay debt service obligations to the lenders and could lead to a default under the finance documents. The Procuring Authority should be aware of this to ensure it is considering the interests of the lenders in assessing a potential scope change and give the lenders the time required to complete their due diligence and associated assessments, and give their approvals.

EXAMPLE

Lender approval requirement

There were a range of changes that had to be implemented on the InterCity Express Programme project in the UK and the associated commercial negotiations were complex and time consuming. Lender approval needed to be secured and this led to the extensive use of external advisors. Nevertheless, the parties were able to work collaboratively to overcome these challenges.

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

It may be difficult to assess how the Procuring Authority should move forward if the lenders ultimately decide that they are not willing to proceed as the new risk profile is outside parameters they are comfortable with and they believe that the Project Company has a legitimate right to reject the proposed scope change. In the case of a major proposed change, this objection may only come at the end of a costly and time-sensitive preparation process. In such circumstances, the Procuring Authority may have limited options. One option would be for the Procuring Authority to agree up front with the Project Company the parameters that the scope change will take and for the Project Company to agree to forgo its right to reject the scope change if it stays within these boundaries. Another possibility might be to undertake it through a separate contractual process outside of the existing contract regime. A more extreme and less common route is for the Procuring Authority to buy out the debt, on the basis that, after the change is implemented, the Procuring Authority will transfer the debt, once the project has reached a new equilibrium.

3.6 Change of ownership

It is not uncommon for an equity investor in a Project Company to seek to change their equity interest (including by selling that interest to a new equity investor) as the Project's risk exposure changes over time. However, in many instances the PPP contract contains restrictions on the ability of equity investors to enter into such transactions. In any event, the Procuring Authority should be aware of this type of activity, and ensure the Project Company remains financially stable and retains the ability to perform its obligations under the PPP contract through the whole duration of a project.

The Project Company involved in a PPP is typically a special purpose vehicle or 'SPV', set up for the sole purpose of owning the assets in a project and complying with its obligations under the PPP contract. The Project Company will be owned by equity investors who have financed the equity portion of the project. Where an equity investor changes its equity interest in the Project Company (including by transferring it) this is typically referred to as a 'change of ownership'. Changes of ownership are also commonly referred to as secondary market transactions.

The definitions of 'change of ownership' and the associated 'change in control' are often defined in a PPP contract and, as indicated, are typically subject to restrictions – including a requirement that such changes can only be made with the approval of the Procuring Authority. The restrictions are designed to protect a Procuring Authority (particularly during the early stages of a project) from the potentially adverse consequences of a change of ownership of the Project Company.

According to our research, approximately 18% of the projects analysed went through a change of ownership that required Procuring Authority approval. A third of those occurred in Europe, with substantial numbers in India and Latin America. There was no apparent difference between sectors in likelihood of a change of ownership. The timescale of the data sample size (projects that reached financial close between 2005 and 2015, inclusive) will have an impact on the overall percentage of changes of ownership, as some projects are still in their very early stages. It is also likely that additional changes of ownership have occurred which did not require the consent of the Procuring Authority.

SECTION STRUCTURE

This section provides a background to Project Company changes of ownership in Subsection 3.6.1 (Background) and provides guidance on managing changes of ownership. The key elements to successfully managing changes of ownership are summarised below and detailed in Subsection 3.6.2 (Guidance).

A. When assessing a change of ownership, consider the interests of the Procuring Authority and broader government considerations

B. Dedicate appropriate resources to assessing a change of ownership including external advisors as necessary

C. Consider the interests of the lenders when assessing a change of ownership

3.6.1 Background

Equity investors may seek to change their equity interest in a Project Company as the project's risk exposure changes over time. For example, a project will be significantly de-risked once construction is complete, defects are rectified and the revenue from the project assets during operations has had time to 'ramp up' and normalise. This de-risking has an impact on the type of equity investor the project is suited to.

The risk exposure of a project at financial close may be well suited to an equity investor that has construction expertise (such as the construction contractor). However, it may be less suitable to that same equity investor once construction completion has occurred and the project is several years into its operations. Similarly, a project that is several years into operations may be better suited to a more risk averse equity investor and such an investor may not have been interested in investing at an earlier stage of the project.

The following circumstances are three examples in which a change of ownership may be appropriate (though there will be additional circumstances which are not adverse to the interests of the Procuring Authority):

- The construction contractor (in addition to having interest in a project as construction contractor) may also be an equity investor in the Project Company. Following construction completion and the initial period of operation, the construction contractor investor may wish to exit the project as its involvement is now limited; its experience no longer required; and its interests are no longer aligned with the interests of the other equity investors. Allowing the construction company to sell its equity interest may enable it to invest in a new project with a construction element. As the Project Company is typically an SPV with few or no assets (other than the project assets) and limited full-time staff, the Procuring Authority will want to ensure that the relevant expertise of the equity investors who control the Project Company is retained through the construction period and likely for some time into operations, particularly if there are concerns about the quality of the construction works or remaining defects. A typical waiting period may be 18 months or more after completion of construction.

- Equity investors' interests can change over time. For example, an equity investor may wish to reduce its overall exposure to a region by diversifying into other regions. When a purely financial equity investor wishes to sell its equity interest (and if the financial equity investor does not bring any particular special skills to the project) its replacement with another equivalent equity investor may not introduce any new risks to the project or diminish the public benefit. In addition, many infrastructure funds are 'closed end', meaning that the fund manager must sell assets and return the investment to the original investors at a given time, which may not align with the end of the PPP contract.
- An equity investor may wish to recycle its capital into new investments, which can be beneficial to the government as more capital will be available for new projects being tendered.

Procuring Authorities are well advised to understand the different drivers and objectives of the prospective equity investors at the time of procurement and agree appropriate restrictions in the PPP contract.

Change of ownership can be addressed in several ways under a PPP contract. They can include provisions requiring the Project Company to seek prior written consent from the Procuring Authority for a change of ownership and/or restrictions on the timing of when a change of ownership can occur. For example, the PPP contract may specify that a period of time must lapse before any disposal is permitted without the Procuring Authority's approval. The Procuring Authority's approval may also contain a positive obligation on the Procuring Authority that its consent will not be unreasonably withheld or delayed. This positive approval obligation may contain a specific timeframe in which the Procuring Authority will need to respond. Any timeframes must be followed to ensure the Procuring Authority is not in breach of its obligations under the PPP contract. A change of ownership may also require approval by the Procuring Authority under the applicable laws.

3.6.2 Guidance

The following guidance outlines the key issues that should be considered when consent of the Procuring Authority is required for a Project Company change of ownership.

A. When assessing a change of ownership, consider the interests of the Procuring Authority and broader government considerations

A request for a change of ownership made to a Procuring Authority should be allowed, provided that such a change does not increase the risk to the government or diminish the public benefit. As described in Subsection 3.6.2 (Background), there can be benefits for the Procuring Authority, the Project Company and the government more generally in allowing changes of ownership, but these benefits must be balanced with the risks associated with such changes.

The following are some examples of how a change of ownership may adversely affect the Procuring Authority and should be considered along with any specific provision in the PPP contract or under the applicable laws:

A. Does the change of ownership adversely impact the ability of the Project Company to carry out its obligations under the PPP contract without the expertise of the relevant equity investor?

B. Is the proposed new equity investor solvent and reputable? Has it fulfilled all of its equity commitment obligations (i.e. has it contributed all of its required equity capital to the Project Company)?

C. Does the change of ownership affect the Procuring Authority's or another government department's liabilities (including contingent liabilities) under the PPP contract or some other applicable law?

D. Does a conflict of interest arise between the Procuring Authority and the proposed new equity investor or another relevant stakeholder? Can it be effectively managed?

E. Is it in the public interest to approve the change of ownership and the introduction of a new equity investor? (For example, public interest may be related to any adverse impact on national security or in regard to the integrity of the proposed new investor.)

Any matters of a sensitive nature related to the Procuring Authority's decision to withhold its consent to a change of ownership (e.g. on the basis of public interest) may be dealt with in a confidential side letter.

There are many instances where the expertise in managing a project's assets are provided by third parties (such as a specific management company) rather than the equity investors themselves. It is important that those arrangements are carefully reviewed and that the required resourcing and expertise to continue to manage the project's assets in an effective manner is maintained through any change of ownership.

EXAMPLE

Considerations for a change of ownership

The Project Company for the anonymised hydropower plant project in Brazil went through a variety of changes of ownership guided by changes in the equity investors' legal structure and ownership. The changes had to be reviewed and approved by the Procuring Authority. When granting its approval for a change of ownership in the Project Company the Procuring Authority's main concern was to ensure that the new equity investors were financially stable and technically capable to continue the operation of the project.

For more information, see the Hydropower Plant Case Study

B. Dedicate appropriate resources to assessing a change of ownership including external advisors as necessary

The Procuring Authority should ensure that it has the necessary financial, legal and technical capabilities to assess a request for a change of ownership. As will be clear from the range of factors described above that need to be considered when assessing a request for change of ownership, substantial efforts may need to be undertaken to achieve this. Similarly, some aspects of the approval process may need legal input, such as what is meant by 'unreasonably withholding' approval of a change of ownership. A technical assessment will need to be made on whether the Project Company will still be able to comply with its obligations under the PPP contract with the new equity investor. If the Procuring Authority does not have the relevant financial, technical or legal expertise in-house, it should appoint external advisors to assist. The use of external advisors is detailed in Section 2.1 (Contract management team set-up).

C. Consider the interests of the lenders when assessing a change of ownership

Lenders also have an interest in changes of control of the Project Company and they may also require a commitment from the equity investors to maintain their financial stakes in the project for some minimum period. Consent from the lenders to a change of ownership is often linked to consent from the Procuring Authority. The Procuring Authority should consider these interests and not use its approval right in a way that will interfere with the ability of the lenders to protect their interests (e.g. by causing unnecessary delays). The interests of the lenders and the Procuring Authority are typically aligned in this situation, as both parties require a financially stable and technically capable Project Company to deliver the project.

3.7 Refinancing

Refinancing refers to changing or replacing the existing lenders or terms on which debt obligations have been agreed between the Project Company and its lenders. The Project Company will have typically raised debt capital for the project and where it has taken the risk on the debt financing it is generally entitled to rearrange it (though often subject to restrictions). The financial structure of the Project Company is also of interest to the Procuring Authority as it can affect the financial integrity of the Project Company and the project. For example, a refinancing has the potential to raise additional debt which can overleverage the project and/or increase the government's contingent liabilities.

In addition, a lack of available financing may mean a project becomes unable to continue operations. Financial distress of the Project Company and insolvency are detailed in Chapter 6 (Insolvency). The focus of this section 3.7 is on managing refinancing where there is an available financial market to raise new debt capital.

Refinancing may also be of interest to the Procuring Authority if the PPP contract contains a provision that any financial gains resulting from a refinancing be shared with the Procuring Authority. For example, see the provisions on refinancing found in the 2017 version of the World Bank's Guidance on PPP Contractual Provisions.[3]

Approximately 15% of projects in the study had a refinancing of debt which required approval from the Procuring Authority. The figures were dominated by Europe, where three quarters of these refinancings occurred. Almost all refinancings identified during the study took place in the transport sector, however it is difficult to know whether this was a result of characteristics of the particular projects studied or whether it is reflective of the data collection process. The timescale of the data sample size (projects that reached financial close between 2005 and 2015, inclusive) will have an impact on the overall percentage of refinancings as some projects are only in their very early stages.

[3] Available at http://ppp.worldbank.org/public-private-partnership/library/guidance-on-ppp-contractual-provisions-2017-edition.

SECTION STRUCTURE

This section provides a background to Project Company refinancing in Subsection 3.7.1 (Background) and provides guidance on managing refinancing. The key elements to successfully managing refinancing are summarised below and detailed in Section 3.7.2 (Guidance).

A. When assessing a proposed refinancing, consider the interests of the Procuring Authority and broader government considerations

B. Dedicate appropriate resources to assessing a potential refinancing including external advisors as necessary

C. Be mindful of opportunities that may be available through refinancing

3.7.1 Background

Changed market conditions and the development of a project can lead to a situation where more favourable financing terms become available (e.g. interest rates become lower). This can be due to improvements in the market itself (e.g. a financial crisis recedes), or changes in the PPP project (for example, construction has completed and the project has established a pattern of successful operations). In these situations, more favourable financing terms may result in lower debt service payments and higher profits for the Project Company. The Project Company will typically seek to take advantage of this. Where refinancing gains are agreed to be shared with the Procuring Authority, the Procuring Authority may be entitled to some portion of the 'financial gain'.

There are other types of refinancing that may occur, not all of which will result in a financial gain:

- Rescue refinancing: The Project Company may need to refinance to avoid insolvency if it is financially distressed. This is typically managed on the private sector side and the Procuring Authority's involvement is limited to approvals of the changes made. It may also involve the contribution of new equity financing.
- 'Mini-perm' refinancing or bridge loan refinancing: In some markets, or during a financial crisis, it is not possible to obtain long-term financing, and loans will be limited to a period much shorter than the contract duration (e.g. five or seven years).

Refinancing in this situation is both necessary and envisaged at the time of financial close and may also deliver financial gains. In some markets, bridge financing is provided at financial close that will only take the Project Company a few years into construction. At that stage, the Project Company may seek to refinance with long-term financing to finance the entire duration of the project.

There may also be circumstances where a Project Company is required to refinance due to its tenor not aligning with the period of the PPP contract and where the market conditions are less favourable meaning that finance becomes more expensive. This will create additional risks for the project.

Some PPP contracts allow for the Procuring Authority to request refinancing but the research suggests that this does not happen often in practice. However, the Procuring Authority on the InterCity Express Programme project in the UK did request a refinancing and the financial gains available were shared between the parties.

EXAMPLE

Benefits of refinancing

The second phase of the InterCity Express Programme project in the UK reached financial close in 2014 and the financing terms were better than those offered for the financing of the first phase in 2012. The opportunity for refinancing was identified by Her Majesty's Treasury with the Procuring Authority issuing a Refinancing Notice to request that the Project Company take advantage of the financing opportunity available. The refinancing was completed in a relatively short period of time with financial gains shared with the Procuring Authority.

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

The following guidance outlines the key issues that should be considered when consent of the Procuring Authority is required for a Project Company refinancing, or the Procuring Authority is otherwise involved.

3.7.2 Guidance

A. When assessing a proposed refinancing, consider the interests of the Procuring Authority and broader government considerations

When a request for approval to refinance is received by the Procuring Authority, or if the Procuring Authority is considering directing the Project Company to instigate a refinancing, the main aim of the Procuring Authority should be to ensure any refinancing does not affect the financial integrity of the Project Company or the project, and to ensure the Procuring Authority will not otherwise be adversely affected.

Refinancing can involve any or a combination of the following: a change to the debt pricing; a change of the debt maturity (its tenor); a change in the amount of debt; a change in the amount of debt relative to equity (i.e. the gearing ratio); changed reserve account requirements (e.g. debt service reserve account); the release of guarantees provided by the equity investors or third parties of the Project Company; a change in the security arrangements (e.g. share charges, project asset security, etc.); a change to the repayment terms (including when capital is required to be repaid); a change in the lenders or debt providers; or a change in other finance terms (e.g. loan covenants).

There are several issues that the Procuring Authority should take into account when assessing a refinancing and how it will affect the project, including those detailed below. The review of the proposed refinancing should be undertaken to ensure that value for money is not adversely affected and taking into account the benefits of the refinancing as well as the potential detriment to the Procuring Authority and the project.

- There may be additional costs where there are hedging or swap arrangements in place. For example, where interest rate hedging or currency exchange rate hedging arrangements need to be ended as part of the refinancing. These types of costs are typically called hedging break costs or swap break costs and may affect whether a refinancing is worthwhile. There may also be hedging gains payable to the Project Company.
- Where the hedging requirements have changed, this may increase the risk in the project. For example, if the Project Company has refinanced with foreign currency debt, that debt may increase the repayment risks for the Project Company in the absence of appropriate hedging.

- Where a refinancing would result in the Project Company taking on additional debt and/or an earlier repayment of equity, it may become highly leveraged (i.e. the percentage of debt in the Project Company would be high compared to the percentage of equity). As a result, there will be a smaller 'equity buffer', making the Project Company and the project more risky and less financially robust.
- The tenor of the refinanced debt may also impact the financial integrity of the Project Company, particularly where the new tenor of debt is shorter than what is required for the project.
- Any protections around cash flow. For example, a debt service reserve account or a contingency repayment period (debt tail) may be amended, leaving the Project Company in a less financially robust position.
- The quality and integrity of lenders providing debt finance may also adversely affect the Procuring Authority's interests.
- A change in the financing arrangements may otherwise increase the contingent liabilities for the Procuring Authority in the case of termination. This needs to be calculated and taken into account when analysing a proposed refinancing.

Although the above list describes some aspects of what issues should be considered by the Procuring Authority, the project financing arrangements of a Project Company can be very complicated. When considering a refinancing, the Procuring Authority should make sure it fully assesses refinancing and engages adequate legal and financial expertise.

EXAMPLE

Use of advisors

On the Brabo I Light Rail project in Belgium, the Project Company was not able to raise long-term debt financing at financial close due to the Global Financial Crisis. Refinancing was completed in 2016, with one of the Procuring Authorities taking the lead in arranging it. A working group was set up and external financial advisors were hired and the refinancing was completed in eight months.

For more information, see the Brabo I Light Rail Case Study.

B. Dedicate appropriate resources to assessing a potential refinancing, including external advisors as necessary

The Procuring Authority will need to do a full assessment of the implications of a given refinancing proposal. This will include ensuring it has the necessary expertise to assess the risks of the refinancing and any potential benefits. This applies to a refinancing requested by the Project Company, as well as the potential for the Procuring Authority to request a refinancing itself.

External advisors will often be needed by the Procuring Authority to assess a refinancing, as it may not have the skills available in-house. The use of external advisors is detailed in Section 2.1 (Contract management team set-up). This will also depend on the Procuring Authority. For example, a large government department may have the expertise available from another part of the organisation or there may be a team available that sits across several projects which has experience with refinancing.

The research indicates that public sector authorities often lack refinancing expertise in-house, and external financial advisors specialised in refinancing are typically required. Issues have arisen due to the time the Procuring Authority has taken to approve refinancing initiated by the Project Company. Where the Project Company is looking to benefit from favourable market conditions, any delays in approvals from the Procuring Authority may lead to the refinancing opportunity being lost.

C. Be mindful of opportunities that may be available through refinancing

Where relevant, the Procuring Authority should also consider the potential benefits it can receive as a result of a refinancing through a relevant refinancing gain regime, if this has been provided for in the PPP contract. It is common in developed markets for the Procuring Authority to require any such financial gain be shared between the parties.

Although a refinancing has the potential to be detrimental to the Procuring Authority, it can also provide a benefit when managed correctly. For example, where additional finance is required to complete works not contemplated at financial close.

EXAMPLE

Refinancing opportunity

On the Queen Alia International Airport Expansion project in Jordan, the refinancing for an accelerated expansion of the airport due to higher than forecast traffic volumes was arranged through both additional debt raising by the Project Company and voluntary contribution from the Procuring Authority. Parliament approved such contribution as it was considered to be value for money to bring forward the planned expansion by three to four years and make a voluntary contribution from the scheduled investment payments.

For more information, see the Queen Alia International Airport Expansion Case Study.

A financial gain can also be generated through a refinancing due to a change in the risk profile of the project or due to a change in market conditions.

How gains are shared between the Procuring Authority and the Project Company needs to be calculated and agreed upon, ideally agreed upon in the PPP contract. Where the PPP contract clearly states how gains are to be share d, this process will be more straightforward. However if the PPP contract does not clearly outline this calculation method then the two parties may have to reach a negotiated outcome.

The financial gain can be distributed to the Procuring Authority in a number of ways including as a lump sum payment, as a reduced unitary charge, as a combination of the two, or by some other mechanism. In a few rare cases, the financial gain is taken 'in kind' as a pre-funded scope change financed with the government's refinancing gain share. This may be difficult to do due to the difficulty in estimating the value of the scope change.

Where a refinancing gain is agreed in a PPP contract, it is also common for some refinancing gains to be excluded. For example, this can occur where a refinancing is contemplated at financial close because the Project Company knows it can get better financing terms after financial close. In these situations the Project Company will argue that these refinancing gains are being taken into account as part of its bid for the project and so should not be shared. In this context, it is important to specifically establish in the PPP contract which circumstances will entitle the Procuring Authority to share in a refinancing gain and when it will not be entitled. Contract managers should be aware of when refinancing gains can be shared to ensure they are making the most of the Procuring Authority's entitlements.