

Model Concession Agreement

For Public Private Partnership Projects

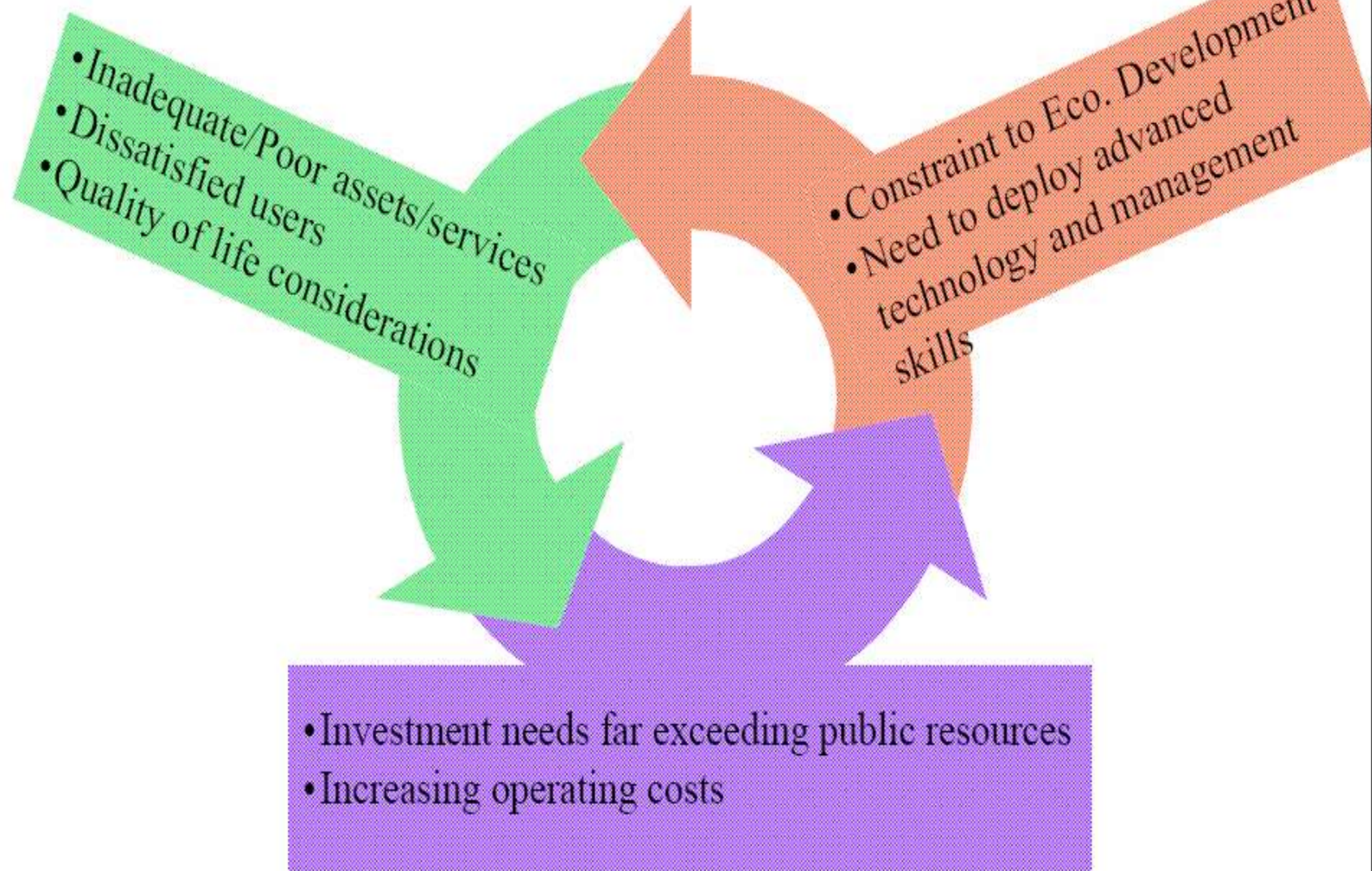
*By - S.K.Saha,
Director, Planning Commission
March 21, 2007*

Public Private Partnership (PPP)

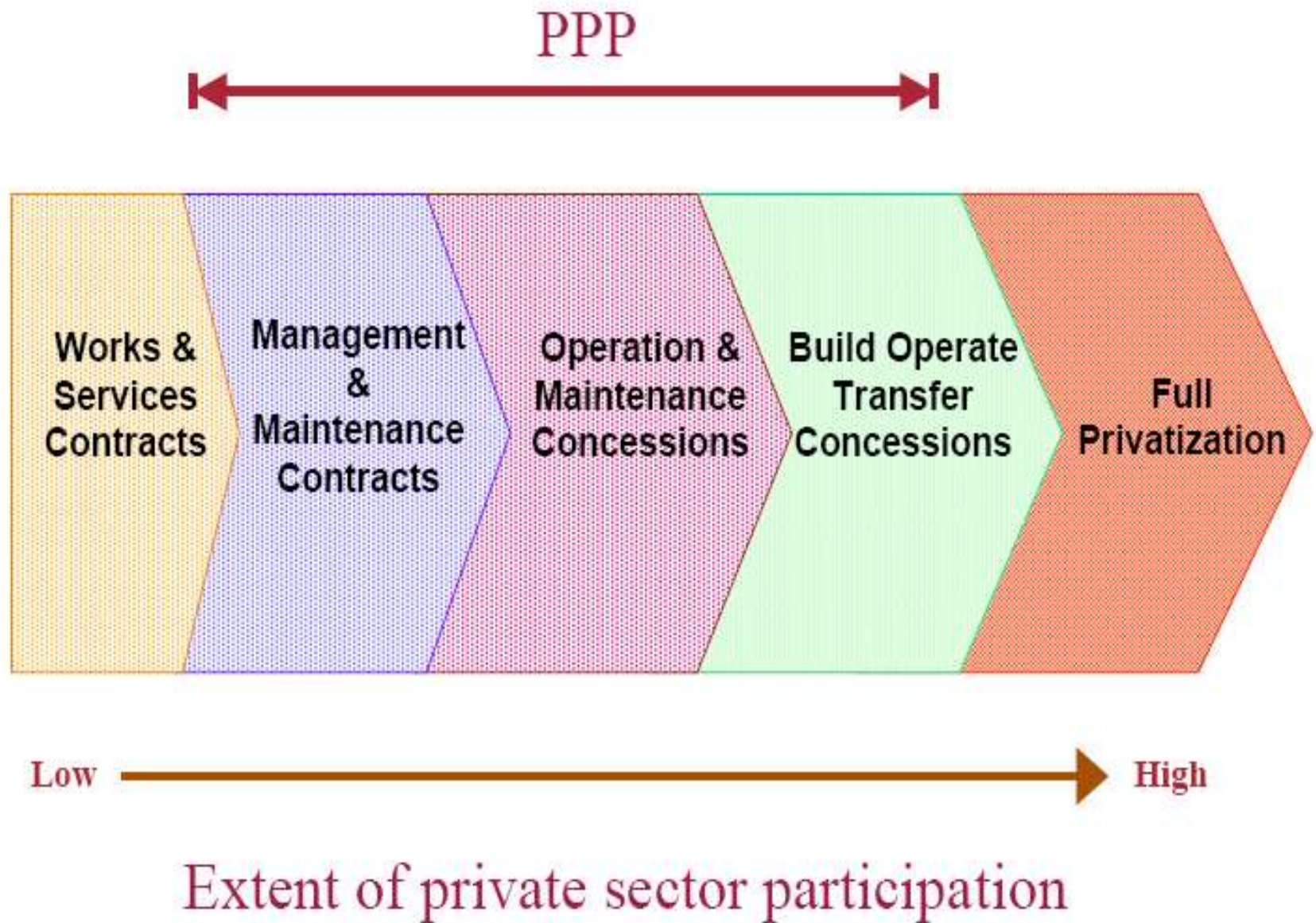


Basics

Why PPP is Needed



Public-Private Continuum



What PPP is not?

- PPP is not the commercialization of a public function under a state-owned enterprise
- PPP is not outsourcing of functions in which financial, technical and operational risk is retained by the sponsoring entity
- PPP is not donation or charitable work by a private party for a public good

So, what is PPP?

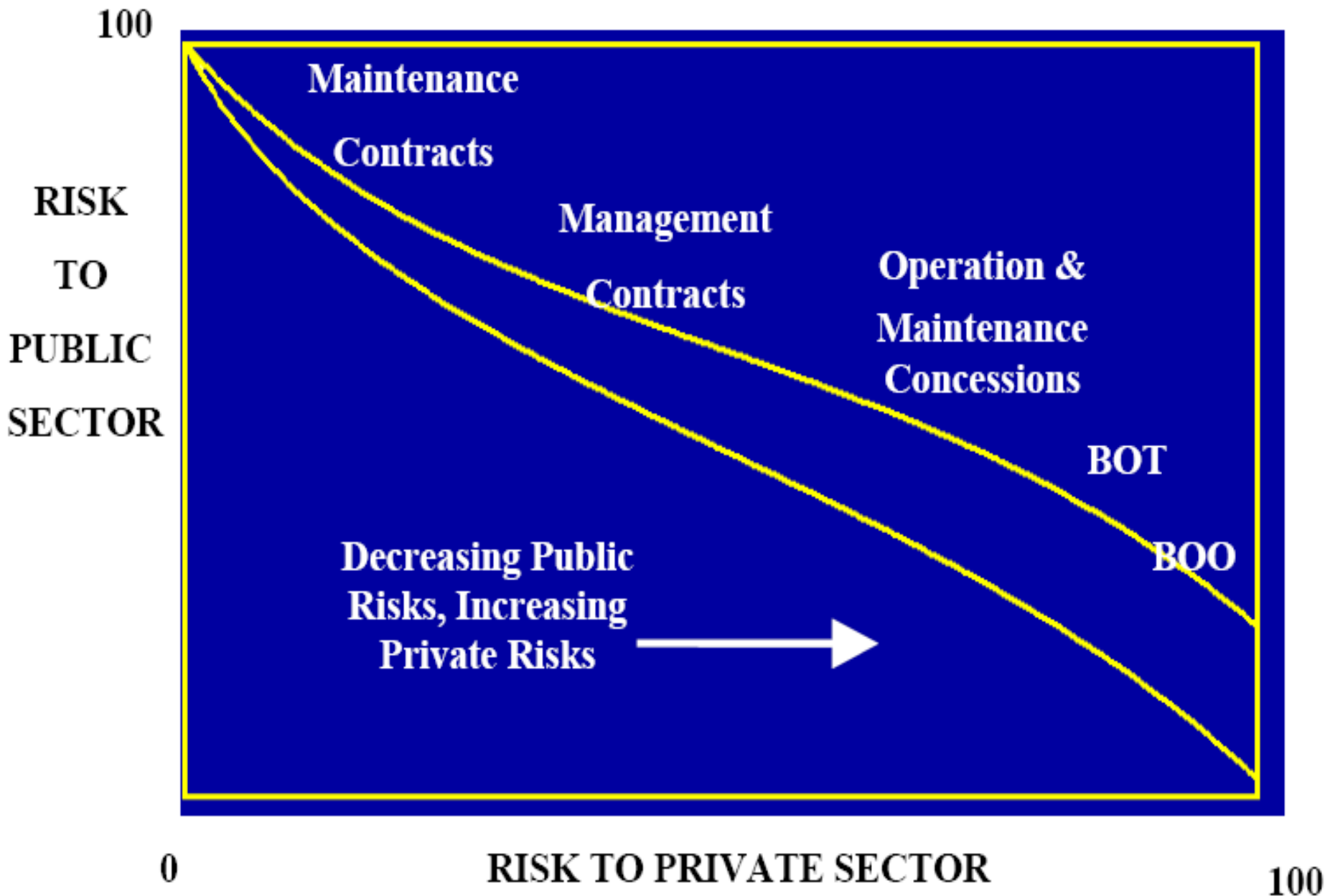
PPP is a contract between a sponsoring public entity and the private sector in which the users and/or public authority pay for services rendered satisfactorily and not for assets, which are inputs to service provision.

What is PPPcontd

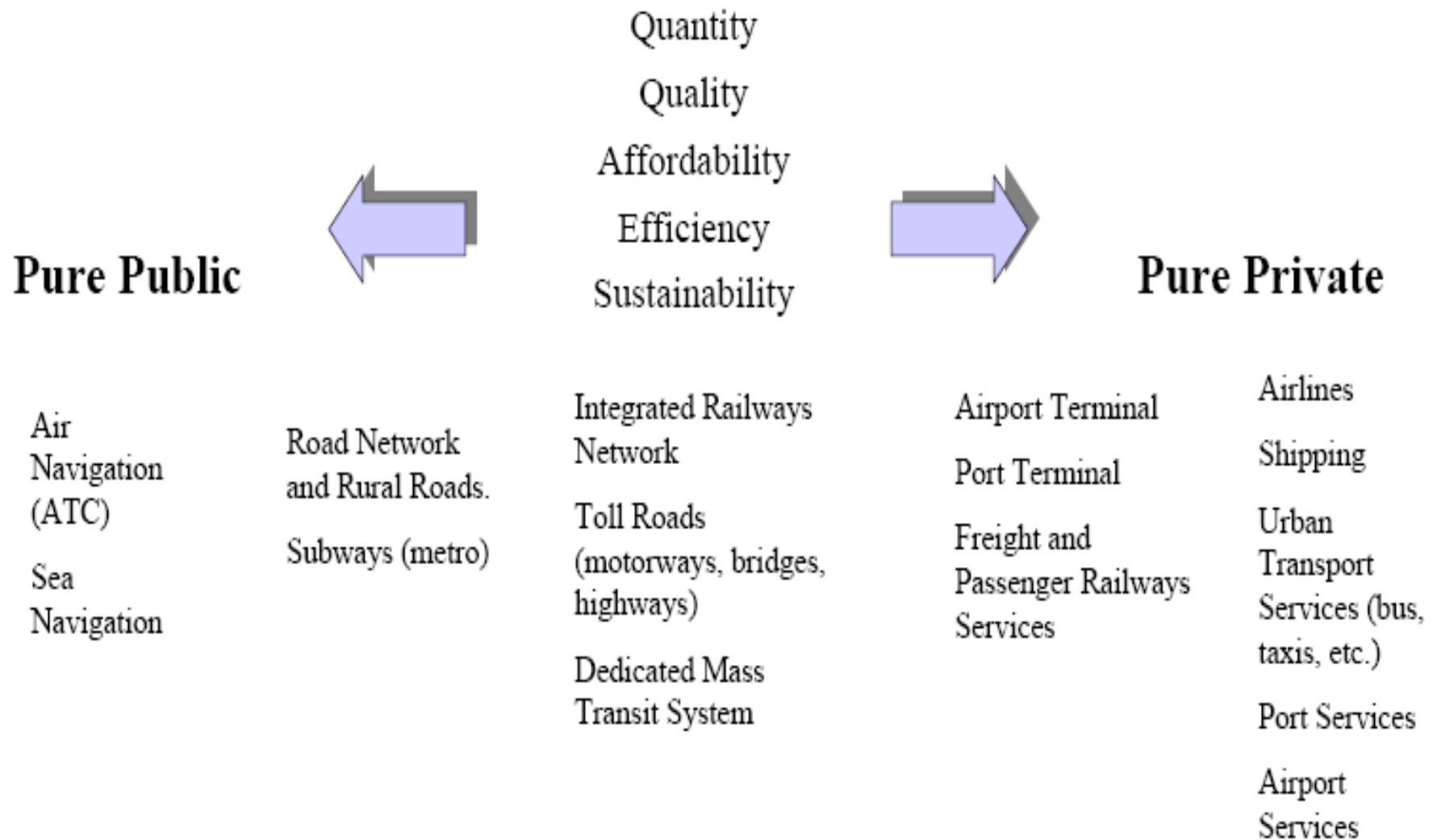
- PPP combines the advantages of both sectors:
- Social responsibility, environmental awareness and public accountability of the public sector
 - Finance, technology, know-how, managerial skills and efficiency, and entrepreneurial spirit of the private sector

It is an efficient way of allocating costs and risks between the public and private partners.

Allocation of Risks



Suitability of PPP



Public Private Initiative (PFI) - UK

- Programmes for developing and financing public infrastructure with private management and private capital
- Aims at low transactions cost

Private Sector involvement needs

- Framework of policy in which investor can expect to make reasonably attractive returns with reasonable exposure to risk, provided they achieve expected level of efficiency.
- Acceptability of private investment to the public requires the assurance that the quality of construction covers up to required standards.
- User charges are reasonable
- Any direct or indirect capital subsidy involved is determined in a transparent manner
- Project requires least cost solution for the economy

Successful Partnership will depend upon

- Nature of concession agreement
- Regulatory environment
- Transparency of the process of awarding concession
- Clarity of policy framework
- Clarity of output/service specifications
- Risk allocation to parties best suited to manage them
- Private investors must bear all risks, which they can reasonably control or insure

The Concession Agreement



Principles

Objectives of a MCA

- Basis of commercialisation in planned and phased manner
- Adoption of best international practices
- Secure value for public money
- Provide efficient and cost effective services to the Users

Issues to be addressed

- Mitigation and unbundling of risks
- Allocation of risks and rewards
- Symmetry of obligations between principal parties
- Precision and predictability of costs and obligations
- Reduction of transaction costs
- Force majeure and termination
- User protection
- Transparent and fair procedures
- Financial support from the Government

Elements of Financial Viability

- Traffic / User volumes
- Tariffs
- Concession Period
- Capital costs

Technical Parameters

- Output specifications
 - Core requirements specified for
 - Design
 - Construction
 - Operation and Maintenance
 - Scope for the concessionaire to innovate and add value
 - Provide flexibility for evolving and adopting cost effective designs
 - Quality of service to users not to be compromised
 - Cost efficiencies due to shift to output based specifications
 - Input based specifications deny opportunity to innovate and optimise designs

Performance Standards

- Concessionaire
 - Procures civil works
 - Procures equipment
 - Provides services
- Monitoring Performance
 - Key Performance Indicators
 - eg – Urban Transport Project
 - » Operation of Trains, Provision of Coaches, Operation of Stations
 - eg - Ports
 - » Dwell time, berth productivity, vehicle service time, ship handling productivity
 - Penalties prescribed for failure in achieving the requisite levels performance

Concession Period

- Length of concession period
 - The expected capacity at the end of the concession period to meet the projected traffic volumes
 - Construction period should be included in the concession period
 - incentivises early completion
 - maximises revenues

Selection of Concessionaire

- Prequalification of Bidders – RFQ stage
 - 4-5 top bidders having financial capability pre-qualified based on experience.
- Bidding – RFP stage
 - All project terms stated upfront in concession agreement such as:
 - Concession period
 - Tariff
 - Price indexation
 - Technical parameters
 - Pre-qualified bidders to bid for the highest revenue share or the lowest grant

Risk Allocation

- Risk to be allocated to the parties that are best able to manage them
- Assignment of Risks
 - Concessionaire
 - Project Risks – Innovation leading to efficiencies in costs and services
 - Commercial & Technical Risks – Relating to construction, Operation & Maintenance
 - Traffic risk – significantly mitigated as the service is generally a monopoly and traffic volumes can be measured with reasonable accuracy.
 - Government
 - Direct and Indirect political risks

Financial Close

- Specify time frame for achieving Financial close
- MCA provides for conditions precedent to be satisfied prior to FC

Tarrifs

- Precise Principles of tariff-setting to be stated upfront
- Helps to determine revenue streams of a project and its viability.
- Partial indexation of tariffs to WPI for the entire concession period

Construction

- Handing over land and obtaining environmental clearances are conditions precedent
- Scope of the project should be defined precisely. Helps to determine costs and obligations.

Operation and Maintenance

- High level of service for the users
- O&M governed by strict standards.
- Operational performance most important test of service delivery.
- MCA provides for elaborate and dynamic mechanism to evaluate and upgrade safety requirements

Rights of Substitution

- Project assets not adequate security for lenders
- Project revenue streams constitute their security
- Substitution rights to lenders are essential

Force Majeure

- MCA defines:
 - Non-Political Events
 - Indirect Political Events
 - Political Events
- MCA provides for:
 - Protection against arbitrary political actions
 - Effects of Force Majeure event on the concession
 - Allocation of costs arising out of Force Majeure
 - Termination payment for Force Majeure event

Termination

- Compulsory buy-out by the Government in case of termination
- Termination payments
 - Political Force Majeure and Defaults by Government adequate compensatory payment to guard against discriminatory/arbitrary actions
 - Debt due + 150% of Adjusted Equity
 - Concessionaire Default
 - No termination payment for termination before COD
 - After COD only 90% debt due payable.

Monitoring and Supervision

- Hands off approach
- Government entitled to intervene in the event of default
- Concession agreement provides checks and balances for accountability of Concessionaire
- Monitoring and supervision of construction and O&M through Independent Engineer (IE)
- IE selected through transparent process.
- Provision for appointment of auditors
- All financial inflows and outflows routed through an escrow account.

A typical Model Concession Agreement



Part – I

Preliminary

- Recitals
- Definitions and Interpretation

Part II

The Concession

- Scope of the Project
- Grant for Concession
- Conditions Precedent
- Obligation of the Concessionaire
- Obligations of the Trust
- Representations and Warranties
- Disclaimer

Part III

Development and Operations

- Performance Security
- Right of Way
- Utilities and Roads
- Construction of the Port Terminal
- Monitoring of construction
- Completion Certificate
- Entry into Commercial Services

Development and Operations ..contd.)

- Change of Scope
- Operation and Maintenance
- Safety Requirements
- Monitoring of Operation and Maintenance
- Traffic Regulation and Security
- Key Performance Indicators
- Traffic and Dwell Time Reports
- Independent Engineer

Part IV

Financial Covenants

- Financial Close
- Grant
- Concession Fee
- User Fee
- Revenue Shortfall Loan
- Effect of variations in Traffic Growth
- Construction of Competing Port Terminal
- Escrow Account
- Insurance
- Accounts and Audit

Part – V

Force Majeure and Termination

- Force Majeure
- Compensation for Breach of Agreement
- Suspension of Concessionaire's Rights
- Termination
- Divestment of Rights and Interest
- Defects Liability after Termination

Part – VI

Other Provisions

- Assignments and Charges
- Change in Law
- Liability and Indemnity
- Rights and Title over the Site
- Dispute Resolution
- Disclosure
- Redressal of Public Grievances
- Miscellaneous
- Definitions

Schedules

- Site of the Project
- Development of the Port Terminals
- Project Equipment
- Specifications and Standards
- Applicable Permits
- Performance Security
- Project Completion Schedule
- Drawings
- Tests

Schedulescontd.

- Completion Certificate
Provisional Certificate
- Maintenance Requirements
- Safety Requirements
- Monthly Fee Statement
- Traffic and Dwell Time Report
- Traffic Sampling
- Selection of Independent Engineer
- Terms of References for Independent Engineer

Schedulescontd.

- Fee Notification
- Escrow Agreement
- Panel of Chartered Accountants
- Vesting Certificate
- Substitution Agreement

Thank You