PUBLIC PRIVATE PARTNERSHIPS

Standardised PPP Provisions

PRESENTED BY:

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Strategic & Technical Advisory

National Treasury
REPUBLIC OF SOUTH AFRICA

Contents

Background to Standardisation

- Length of time to close deals
- Uncertainty in the market
- High bid costs
- High advisors’ fees
- Disparity of risk allocation across various PPP agreements

Objectives of Standardisation

- Shorten contract negotiation time
- Create market certainty about optimal risk allocation
- Reduce bid costs
- Reduce transaction costs
- Consistency irt affordability, Value for Money and risk transfer

Consultation Process

Completed mid 2002:
- Steering Committee's first draft

Completed end 2002:
- Review Group input
- Public Sector Draft

Completed early 2003:
- Public sector comments
- Review Group consulted
- Private Sector Draft produced

Completed late 2003:
- Private sector comments received
- Private sector hearings
- Working Group sessions
- Steering Committee decision on final positions

Early 2004
- Final document produced
- May 2004: official document issued

Steering Committee
- PPP Unit
- Legal Advisors
- Partnerships UK
- Project Coordinator

Review Group
- Lawyers
- Banks
- FM Operators
- Construction industry
- IT industry
- Empowerment interests

Public Sector

National & provincial departments & Schedule 3 public entities

Private Sector

All interested parties

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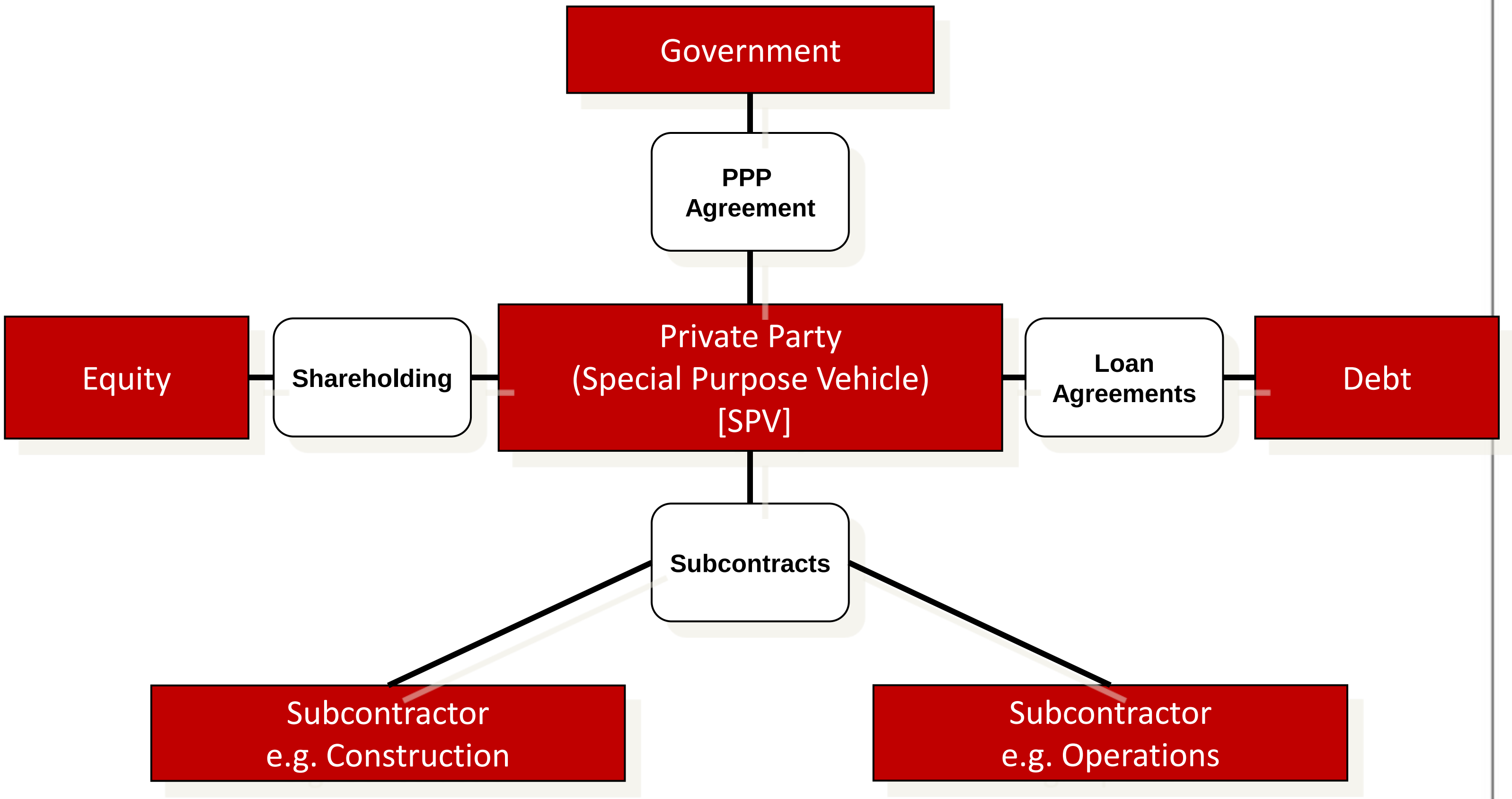
Status

- Suggested / recommended positions
- Prescribed positions
- Standard Clauses and Standard Definitions
- Deviations permitted
  - If justified
  - With National Treasury's approval

Application

- Applies to:
  - Regulation 16 Institutions (issued in terms of PFMA; amended 2004)
    - National departments
    - Provincial departments
    - Schedule 3 public entities and business enterprises
    - [Not to local government - municipal finance management act]
  - PPPs that use limited recourse project finance

Assumed SPV Structure



Service Availability and the Payment Mechanism

Standardisation: Part E: page 95

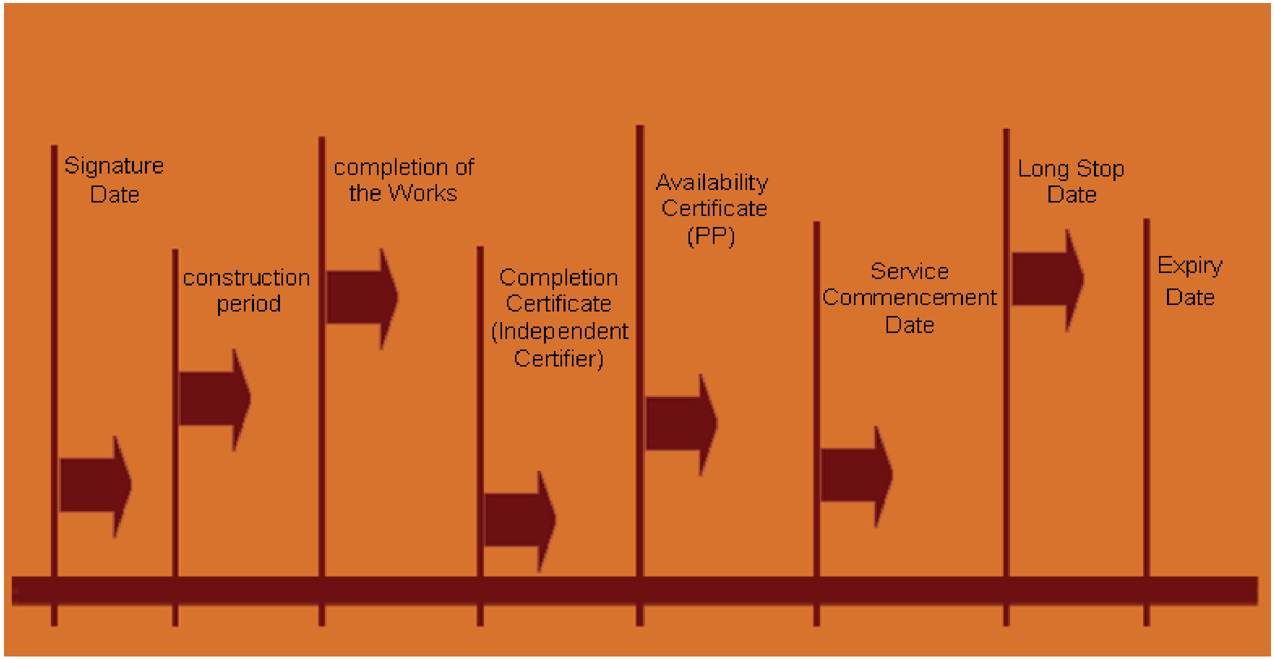
Part F: Page 114
Part H: Page 142

Design Risk and Certification

- Design Risk: that the design of the Facilities may not achieve the required output specs
- Prescribed approach: PP risk (18.1.3)
- Institution can monitor and review, but not approve, the design
- Independent Certifier issues Completion Certificate
- PP can now issue the Availability Certificate

Service Commencement and Availability

- Availability Certificate issued:
  - Services deemed to be available
  - Unitary Payment payable from that date
  - “Service Commencement Date”
- Significance of the definition of “Services” and “Availability” in PPP Agreement



Performance and Payment

- Payment mechanism puts into financial effect the risk allocation b/w the Parties
- Standard clause, pg 153
- Prescribed clause (23.1):
  - Services to be available in acc with the output specs
  - Penalty Deductions may be made from the Unitary Payment for:
    - Unavailability of the Services; or
    - Poor performance

Standardisation: Part J: page 184

Relief Events

- PP prevented from performing its obligations
- Best managed by PP (although not necessarily within its control)
- Generally insurable
- PP bears financial risk ito increased costs and reduced revenue

Relief Event: Definition

- List can be modified for specific sectors if commercial risk remains with PP
- Std Definition, pg 187:
  - Fire, explosion, flood, earthquakes, strikes, riots,
  - Damage to the Works …
- Proviso: not a Relief Event if caused by PP or a Subcontractor

Relief Event: Consequences

- Std Clause, pg 189
- (a) PP given relief from:
  - LDs for late Service Commencement
  - Termination for failing to provide Services
- (c) Scheduled Service Commencement Date postponed
- Project Term not extended, ie Expiry Date unchanged
- (d) Penalty Deductions still accrue (suspended for termination purposes)

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Compensation Event: Definition

- Std Definition, pg 192
- Breach by Institution of its obligations (but the breach doesn’t constitute an Institution Default)
- Not caused or contributed by PP or any Subcontractor, therefore Institution’s risk
- List can be modified for specific sectors
- “Time” (Relief Event) vs “time and money” (Compensation Event)

Compensation Event: Consequences

- Std Clause, pg 199
- (a) PP entitled to apply for relief from its obligations and/or claim compensation
- (c) Long Stop Date postponed
- PP compensated for additional capex costs
- Unitary Payment adjusted to compensate for additional opex costs
- PP relieved from obligations

Force Majeur: Definition

- Std Definition, pg 203
- War, terrorism, contamination
- Proviso: to the extent uninsurable
- Directly causing either Party’s inability to comply with its obligations
- Neither Party better able to bear FM risk
- Risk of FM consequences to be shared

Force Majeur: Consequences

- Std Clause, pg 203
- (a) Either Party relieved of liability from failure to fulfil obligations
- (g) Unitary Payment reduced to compensate for available Services
- Right to terminate by either Party
- Possible extension of Project Term

Standardisation: Part N: page 248

Causes of Termination

- On Expiry Date (effluxion of time)

- Pre-Expiry Date:
  - Corrupt Acts
  - (Std Definition pg 259; Std Clause, pg 260)
  - Force Majeure
  - (Std Definition pg 203; Std Clause pg 256)
  - Institution Default
  - (Std Definition pg 249; Std Clause pg 250)
  - PP Default
  - (Std Definition pg 251; Std Clause pg 254)

- Std Clause (c), pg 262: Institution can recover from PP the greater of:
  - Amount or value of the consideration; and
  - Direct losses sustained by the Institution as a result

- Std Clause, pg 302:
  - Debt less deductions;
  - Zero compensation on Lender corruption

Force Majeur Compensation

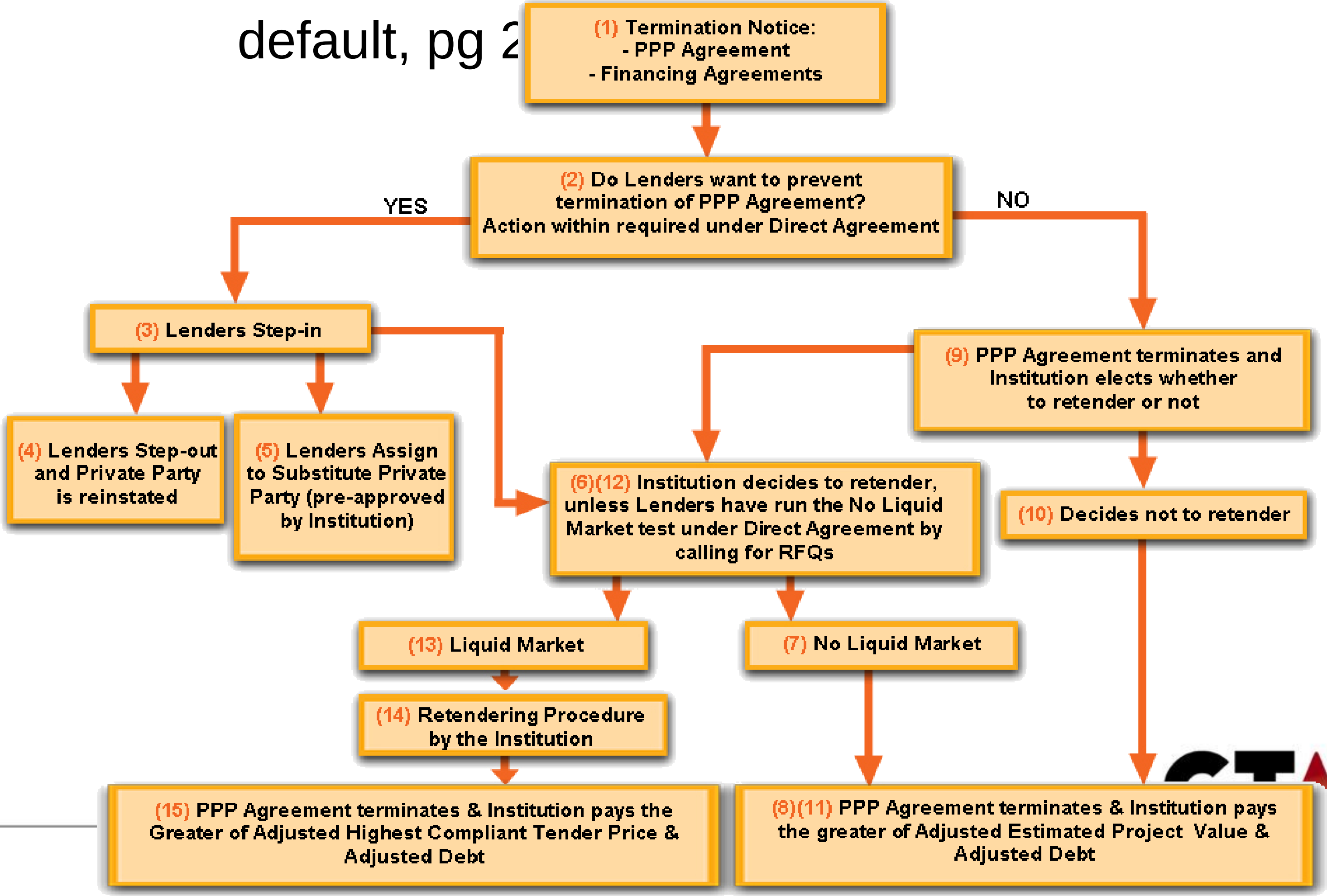
- No-fault principle: consequences shared
- Compensation somewhere b/w that payable for Institution and PP default
- Std Clause, pg 300
- Institution pays A – B, where:
  - (A) = Debt + Return of Equity; and
  - (B) = Liquid amounts (e.g. credit bank balances) + set-off amounts

Institution Default Compensation

- Principle: Institution’s fault therefore Institution’s risk
- Std Clause, pg 274
- Institution pays A – B, where:
  - (A) = Debt + Return on Equity; and
  - (B) = Liquid amounts (eg credit bank balances) + set-off amounts

PP Default Compensation

- Why compensate at all?
- Schematic of process on termination for PP default, pg 2



PP Default (continued)

- (1) PP defaults under PPP Agreement or Financing Agreements
- (2) Institution's right to terminate subject to Lenders' rights under the Std Direct Agreement: SDA 3, pg 319
- (3) Lenders Step-in ito SDA: SDA 5, pg 321
- (4) Lenders Step-out and PP is reinstated
- (5) Lenders can appoint a Substitute PP: Footnote 503, pg 319 and SDA 8, pg 323
- (6) Lenders can run the "No Liquid Market" test: footnote 446, pg 280 and SDA 4, pg 320
- (7) If No Liquid Market, "No Retendering Procedure" applies: SDA 4(d), pg 320
- (8) No Retendering Procedure: Std Clause, pg 297
- Std Clause (e): Institution pays PP the <u>greater of</u> Adjusted Debt and Adjusted Estimated Project Value

PP Default (continued)

- 9) If Lenders do not Step-in under SDA, Institution has a Retendering Election
- Std Clause, pg 281
- (10) No Retendering Procedure: Std Clause, pg 297
- (11) Std Clause (e): Institution pays PP the <u>greater of</u> Adjusted Debt and Adjusted Estimated Project Value
- (12) If Institution decides to retender; or
- (13) if Lenders' “No Liquid Market” test shows there is a Liquid Market]
- (14) Retendering Procedure by Institution: Std Clause, pg 289
- (15) Std Clause (e) and (q): Institution pays PP the <u>greater of</u> Adjusted Debt and Adjusted Higher Tender Price

Unforeseeable Discriminatory Government Conduct

Standardisation: Part K: page 205

- PP obliged to comply with applicable law
- Failure could mean breach and termination
- Cost of complying with current or foreseen law usually built into bid price
- Who is responsible for costs arising from unforeseen changes in law?

Unforeseeable Discriminatory Government Conduct

- PPs often seek relief from the material adverse consequences of govt conduct (not a change in law) affecting ROE, debt service or costs
- Who is responsible for costs arising from "Unforeseeable Conduct"?
- MAGA terminology

Unforeseeable Conduct: Definition

- Std Definition, pg 208
- After Signature Date, Institution takes any action (incl change of any law) or fails to carry out its obligations; and
  - (a) discriminatory effect
  - (b) PP not entitled to other relief
  - (c) not foreseen
  - (d) not foreseeable

- Std Clause, pg 209
  - (a) Material adverse Unforeseeable Conduct: Institution to compensate PP to put it in same overall economic position it would have been in
  - (b) Material beneficial Unforeseeable Conduct : PP compensates Institution to put it in same overall economic position it would have been in

Standardisation: Part Q: page 329

- Change in project's funding structure, as originally approved by Institution when signed
- PP's distributions effectively increased
- Refinancing Std Definition, pg 331
- Refinancing Gains to be shared 50:50
- Refinancing Gain Std Definition, pg 331
- No Refinancing Gain-sharing iro Exempt Refinancings
- Exempt Refinancing Std Definition, pg 337
- Institution's prior written approval required for a Refinancing
- Institution's approval not required irt an Exempt Refinancing (notification still required)

The Way Forward

- Standardisation must reflect market practice
- Sector-specific PPP Toolkits to follow
- Ultimate test of bankability: extent of incorporation in bid documents

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