STANDARDISED PPP PROVISIONS

(“Standardisation”)

<u>PRIVATE SECTOR DRAFT</u>

[May 2003]

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PREFACE

(A) Introduction

This Standardisation describes the key issues that are likely to arise in public private partnership ("**PPP**") projects regulated by the provisions of Regulation 16 of the Treasury Regulations ("**Regulation 16**").[1] It prescribes how these key issues must be dealt with in PPP agreements in a manner that achieves the requirements of "affordability", "value for money" and "appropriate risk transfer" as these terms are defined and otherwise dealt with in Regulation 16.

Key issues that are not capable of standard treatment (either because of sector-specific requirements or because of specific circumstances affecting a particular PPP project) are identified in this Standardisation but are not given detailed consideration. Institutions must seek to identify such issues during the feasibility study phase of a PPP project, that is, in the phase preceding the issue of Treasury Approval: I (as defined in Regulation 16 ("**TA:I**")), and bring them to the attention of the relevant Treasury (currently, the National Treasury) in the application for TA:I.[2]

The objectives of this Standardisation include the promotion of a common understanding of the technical, operational and financial risks that are typically encountered in PPP projects, a common understanding of how such risks must be transferred or shared among the parties involved in the delivery of PPP projects, a consistent approach to risk transfer and sharing and value for money across PPP projects falling within the same sector, and a reduction of the time and cost of negotiation of the parties involved in a PPP project.

It is important to note that this Standardisation (like Regulation 16) focuses on the appropriate risk profile of PPPs. It does not focus on whether PPPs are suitable mechanisms for service delivery (as opposed to "internal" mechanisms for service delivery traditionally used by departments, public entities, government business enterprises and other institutions that are subject to Regulation 16 ("**Institutions**")),

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1 Treasury Regulations for Departments, Trading Entities, Constitutional Institutions and Public Entities, published in GN 740 *GG* 23643 of 25 May 2002 (the "**Treasury Regulations**") promulgated in terms of the Public Finance Management Act, 1999 (the "**PFMA**").

2 Treasury Regulation 16.4.

nor does it focus on the identification of the types of PPPs that are suitable for pursuit by such Institutions.[3] The responsibility for identifying whether a PPP is and the particular type of PPP that is suitable for an Institution's strategic and operational needs and requirements resides with the Institution, since it is best placed to identify its needs and requirements.

As stated above, sector-specific issues are not addressed in this Standardisation. Accordingly, this Standardisation is no substitute for a comprehensive consideration of all issues relevant to a PPP project. Rather, its aim is to assist in the conduct of such consideration. The National Treasury intends to prepare, in due course, sector-specific standardisations, which will complement this Standardisation.

This Standardisation must be used, where so indicated, in conjunction with the guidances on PPPs published by the National Treasury from time to time. The following guidances are referred to in this Standardisation:

(a) Feasibility Study Guidance;

(b) Procurement Guidance;

(c) Empowerment Guidance;

(d) Contract Management Guidance;

(e) Auditor-General Guidance; and

(f) Accountant-General Guidance.

(B) **Assumptions**

Given the complexities associated with trying to achieve these objectives across a wide range of diverse sectors each with different funding requirements for service delivery, a number of assumptions have been made in this Standardisation. These assumptions are that:

[3] These Institutions comprise constitutional institutions, national and provincial departments and those national and provincial government enterprises and national and provincial public entities that are listed from time to time in Schedule 3 to the PFMA unless specifically exempted pursuant to section 92 of the PFMA or Treasury Regulation 16.11.

(a) the "Private Party" (as defined in Regulation 16, and referred to in this Standardisation as the "**Private Party**") to a PPP agreement is a special-purpose vehicle ("**SPV**") incorporated in the Republic of South Africa in accordance with applicable law as a private limited liability company for the sole purpose of exercising its rights and performing its obligations under the PPP agreement;[4]

(b) the PPP project involves an initial design and construction (or development) phase and a later operational phase during which the required services will be provided;

(c) the project deliverables (collectively all the rights and obligations of the Private Party in relation to both phases of the PPP project) will be subcontracted down by the Private Party to others (these subcontractors usually being the shareholders of the SPV or parties related to them (that is, affiliated or associated companies)). These subcontracts will include a design and construction (or development) subcontract and an operations and maintenance subcontract; and

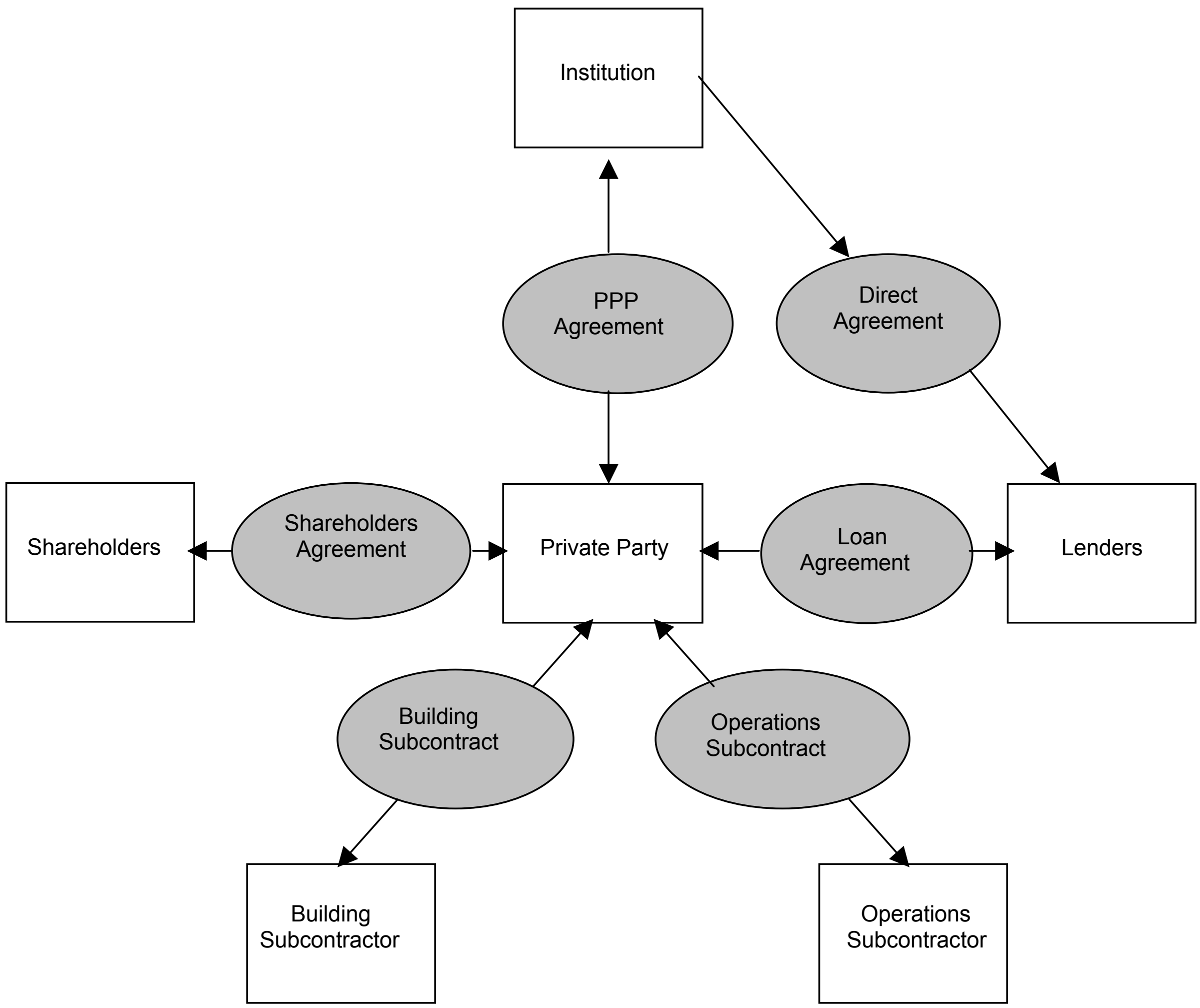
(d) substantial funding for the PPP project is to be provided by limited-recourse debt to be made available by financiers (other than the shareholders or related parties of the Private Party) who will look primarily to the cash flows generated from the PPP project (that is, the charges payable by the Institution for the delivery of the project deliverables or the user charges collected from end-users of the delivered services) to service that debt. Since the cash flows generated in a PPP project will depend on the sustained delivery by the Private Party of the agreed services at the prescribed performance levels, poor performance by the Private Party will put the servicing of such debt at risk. These financiers will be able to mitigate such risk in part through step-in and substitution

[4] The main justifications for ring-fencing the business of a PPP project in such an SPV are, first, to limit an Institution's exposure to the risks of insolvency of the shareholders of the Private Party, secondly, to insulate a PPP project from the risks associated with any other business (that is, non-PPP project business) that may be carried on by the Private Party, thirdly, to ring-fence the cash flows and expenditure of the Project from that of any other non-PPP project business, fourthly, to ensure the creation and spread of empowerment equity, fifthly, to simplify the monitoring of the performance of the Project and, lastly, to simplify any handback of the Project Assets at the end of the Project Term.

As part of the Institution's due diligence, the Institution should request and review all documents required in terms of the Companies Act, 1973 for the incorporation of the Private Party as a private limited liability company including its memorandum and articles of association to ensure that all tender requirements regarding the objects, capacity, powers and capital structure of the Private Party have been complied with.

mechanisms implementable in terms of direct agreements between them and the Institution.

The basic contractual arrangements posed by the funding structure referred to in these assumptions are reflected in the following organogram:



The above assumptions reflect the prescribed funding structure for all PPPs. However, this funding structure will not always be appropriate. It will usually only be appropriate in relation to PPP projects that are highly capital intensive and therefore require funding sources with relatively low costs (compared to pure equity funding). A different funding structure may be more appropriate in PPP projects which are not highly capital intensive.

PPP projects may also be funded from the balance sheet resources of Private Parties (so-called "corporate finance") or through capital contributions by Institutions and/or other public-sector bodies. An Institution should consider all alternatives to limited-recourse debt (so-called "project finance") if they comply with the prescribed risk profile as set out in this Standardisation, meet the value for money and affordability levels set for its proposed PPP project and, in addition, if they are able to accommodate mechanisms for the ring-fencing of all cash flows from the proposed PPP project.[5] A key feature of this prescribed risk profile is that funders of private capital must assume performance risk.

In a corporate finance structure, a Private Party arranges the funding necessary to meet the capital and other expenditure requirements of the PPP project from its own balance sheet resources (or those of its shareholders and related parties). In such a structure there is no need for an SPV to ring-fence the PPP project or for a direct agreement between the Institution and any third party financiers. This type of structure can be used across all sectors in PPP projects with capital requirements below the levels at which project finance becomes cost effective. In the absence of third party financiers taking credit risk on service delivery by Private Parties at sustained performance levels, Institutions will need to conduct a comprehensive due diligence into the financial strength and creditworthiness of any bidder proposing a corporate finance structure. Having regard to the outcome of such due diligence, the required value for money and affordability levels set for a PPP project and any capital contributions to be provided by the public-sector, an Institution may also need to consider whether or not it should require the Private Party to furnish it with any security (such as on-demand performance bonds to secure the performance obligations of the Private Party and letters of credit and/or parent company guarantees to secure the repayment of the capital contributions by the public-sector) or to maintain any credit ratings for the duration of the PPP agreement.

The relevant Institution and/or other public-sector bodies may contribute a substantial portion of the capital required for a PPP project. Such capital may be contributed as grants although this is not always possible given the budgetary and regulatory

5 The ring-fencing of cash flows in a Project with a non-project finance funding structure is necessary to enable the Institution to monitor the cash flow of PPP projects. This is essential in the case of revenue-generating PPP projects.

framework applicable to the relevant Institution or other public-sector bodies. It is essential that the budgetary and regulatory requirements applicable to the Institution or public-sector bodies be meticulously complied with before any commitment is made to provide capital funding of this sort. The tax implications of this funding structure must be carefully considered, particularly in relation to VAT. Legal restrictions on the holding of shares by government entities in companies in which the private sector also holds shares, as well as the provisions of chapter 8 of the PFMA, must also be borne in mind when deciding how to structure these capital contributions. The provision of these capital contributions by Institutions and/or other public-sector bodies obviously affects the allocation of risk. This funding structure should only be used where the funds concerned are to be applied by the Private Party in the provision of assets (movable and/or immovable) for the PPP project that will either immediately or on termination of the Agreement become the property of the Institution or public-sector body concerned. How this will be achieved must therefore also be carefully analysed and provided for. Again, the VAT and other tax consequences of any such transfer must be taken into account. The assets so provided can clearly never be available to secure obligations of the Private Party to any third party creditors (including its funders). These assets must also be fully "ring-fenced" so that even if they are not made available formally as security to third party creditors, they should also not be capable of being attached by such creditors in any circumstances. The use of this funding mechanism must not result in inappropriate risk being retained by, or passed back to, the Institution or relevant public-sector bodies.

(C) Types of PPPs

This Standardisation applies only to those types of PPPs which are subject to Regulation 16. The PPP definition in Regulation 16 distinguishes between two basic kinds of PPP, one involving the performance by a Private Party of an "institutional function" and the other involving some form of "use of state property" by a Private Party for its own commercial purposes.[6]

[6] The extension of the concept of PPPs to the "use of State property" was introduced in May 2002. A project may often involve both kinds of PPP.

(a) *Performance of an Institutional Function*

As regards the first type of PPP, the concept "institutional function" is defined broadly as an ongoing service, task, assignment or other function (or any part or component thereof) that an Institution performs "in the public interest" or "on behalf of the public service generally". This may include any part or component of any ongoing service, task, assignment or function included in, or ancillary to, the functional areas of the national and provincial governments set forth in Schedules 4 and 5 to the *Constitution of the Republic of South Africa*, 1996 (the "**Constitution**"), which an Institution performs in the public interest or on behalf of the public service generally. The phrases "in the public interest" and "on behalf of the public service generally" are broad and could encompass any function whatsoever that is performed by an Institution since, in a sense, everything done or to be done by any entity in the public administration is or must be done in the public interest or on behalf of the public service. However, the broadness of these phrases and the fact that Regulation 16 does not expressly exclude any type of institutional function from being performed by a Private Party pursuant to a PPP agreement does not mean that an Institution may outsource *any* institutional function to the private sector. Certain institutional functions are reserved under applicable law for performance only by the Institutions concerned and may not be "outsourced" to the private sector. This Standardisation does not provide guidance regarding the lawfulness of any outsourcing proposed by an Institution. Instead, the responsibility for identifying the lawfulness of the proposed outsourcing of a function by an Institution rests with that Institution.

Accordingly, an Institution wishing to outsource an institutional function to a Private Party must take due cognisance not only of Regulation 16, but also any restrictions against and requirements for PPPs arising under any other applicable law. It should be noted that as part of the feasibility study included in its application for TA:I, each Institution must obtain legal opinion on the extent to which the relevant institutional function or use of State property can "*legally*" be performed by a Private Party in terms of the PPP agreement.[7] Guidance regarding the required scope of legal opinion (including the nature of the legal risks to be considered in this opinion) is contained in the Feasibility Study Guidance.

It should also be noted that there is nothing in the PFMA or the Treasury Regulations to indicate that PPPs may be used to limit an Institution's responsibilities in performing its institutional functions efficiently and in a manner which demonstrates its accountability for such performance, or that PPPs are the sole or preferred option for the performance by an Institution of its institutional functions. This means that, notwithstanding the delegation pursuant to a PPP agreement of any institutional function (or part thereof) by the Institution to a Private Party, the Institution remains accountable for the efficient delivery of such function.[8]

PPPs for the performance of institutional functions entail "*output*" based procurement, pursuant to which an Institution procures the performance and delivery of an institutional function on its behalf by a Private Party where such performance and delivery are subject to specified "*outcomes*" or "*target*" measures such as quality, efficiency and quantity. This is in contrast to "*input*" based procurement where an Institution is procuring goods, other assets and/or services from a private sector party that will enable the institution itself to perform and deliver its institutional functions. In other words, PPPs exclude conventional procurement transactions such as the procurement of civil works construction, agreements for the supply of goods and agreements for the provision of services by the private sector not amounting to the performance of an institutional function. In these conventional procurement transactions, the institution performs its institutional functions while the private sector party's performance obligations in relation to any such institutional functions are purely input driven, that is, to supply the inputs required for the continued performance by such institution of its institutional functions. The significance

[7] Treasury Regulation 16.4.1(b)(ii).

[8] Treasury Regulation 16.8.2 provides expressly that: "A PPP agreement does not divest the accounting officer or accounting authority of the responsibility for ensuring that the relevant institutional function is effectively and efficiently performed in the public interest."

of this distinction lies in the nature and allocation of the risks associated with the procurement in question between the institution and the private sector party. Conventional procurement does not entail significant risk transfer to the private sector and is not governed by Regulation 16.[9]

(b) *Use of State Property*

As regards the second type of PPP (that is, the "use of state property"), the concept "property" is defined in Regulation 16, but not "use". "Property" is broadly defined as all movable and immovable property belonging to the state including intellectual property rights. In its broadest form, the term "use" in relation to property may include a variety of use forms recognised in our law including, but without limitation, those arising under a contract of "lease" or a contract of "concession".[10]

While the definition of a PPP in Regulation 16 does not exclude or limit the types of use of state property that will be governed by Regulation 16 (provided such use meets the requirements of affordability, value for money and appropriate risk transfer), certain types of use are not regulated by Regulation 16 but rather by other provisions of the PFMA and the Treasury Regulations.[11] Since the legal consequences of the nature of various types of use vary substantially, legal advice should be sought regarding the type of legal arrangement that best fits the nature of the use rights that an Institution wishes to contract out to a Private Party in a PPP agreement. This should be established at the feasibility study phase. This Standardisation does not reflect a preference on the part of the National Treasury for any one-use type over another. Rather, this should be established on a project-by-project basis.

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9 The State Tender Board Act, 1968 and the State Tender Board Regulations (See GN R1237 *GG* 11308 of 1 July 1998) as well as provincial procurement legislation remain relevant in relation to conventional procurement.

10 For a discussion on the distinctions between leases and concessions, see Part D *(Project Sites)*.

11 For instance, Regulations 13.2 and 32.2 of the Treasury Regulations prohibit accounting officers of departments and constitutional institutions and accounting authorities of public entities from entering into a lease (defined as a contract conferring on the lessee the right to the use of any property, plant and equipment for a fixed period of time with a fixed schedule of payments to the lessor) on behalf of that department, institution or public entity, if that lease constitutes a "*finance lease*". This will be the case if, for instance, the lease is for *the economic life* of the asset even if title is not transferred, the lessor *transfers ownership* of the leased asset to the lessee at the end of the lease period, or the lessee has the *option to purchase the leased asset at a price which is expected to be lower than the fair value thereof at the date the option becomes exercisable* so that at the inception of the lease it is reasonably certain that the option will be exercised. In sum, a finance lease is a lease where the lessee assumes the risks and obligations arising arise from ownership, by contrast to an "*operating lease*" (defined in Regulation 1.1 of the Treasury Regulations) where the lessor retains such risks and obligations. Finance leases are governed by chapter 8 of the PFMA and Treasury Regulation 13.

(D) **Implementation**

As stated in the Introduction, this Standardisation does not seek to impose a standardised treatment of any key issue arising in PPP projects across all sectors to the extent that any sector-specific requirements justify specific treatment.

Nevertheless, an Institution seeking to deviate from the standardised treatment prescribed in this Standardisation in relation to a proposed PPP, whether because of sector-specific requirements or to utilise a funding structure other than a project finance structure or for any other reason, must identify any such deviations and explain its reasons for such deviations in its application to the relevant Treasury for Treasury Approval: IIA (as defined in Regulation 16, and referred to herein as "**TA:IIA**"), this being required to be obtained in respect of any proposed PPP agreement before that proposed PPP agreement is put out to tender.

This Standardisation also sets forth standard clauses and definitions that relate to those issues for which there ought to be standardised treatment (unless, in relation to any particular standard clause or definition, the contrary is specifically stated). These standard clauses and definitions should be included (where appropriate) in all PPP agreements without any substantive amendment. An Institution that wishes to deviate from any of the standard clauses and definitions in its proposed PPP agreement must identify these deviations and explain its reasons for them in its application for TA:IIA. Any substantive amendments to any standard clauses and definitions incorporated in a proposed PPP agreement for which a TA:IIA has already been granted will require written approval from the relevant Treasury.

(E) **Timing**

This issue of the Standardisation must be complied with by all Institutions in respect of any proposed PPP agreement for which a TA:IIA has not yet been granted as at the date hereof. Thus, in the case of any new PPP project and any existing PPP project for which only TA:I has been granted as at the date hereof, any proposed PPP agreement relating to it must conform to this Standardisation save to the extent that a proposed deviation from this Standardisation has been notified to and approved by the relevant Treasury.

Any proposed PPP agreement which has been approved pursuant to a TA:IIA or Treasury Approval: III (as defined in Regulation 16, and referred to herein as **"TA:III"**) granted by the relevant Treasury at any time before the date of this issue of the Standardisation will not have to be amended in order to conform to this Standardisation. Any such proposed PPP agreement must continue to be dealt with by the relevant Institution in line with the terms and conditions of the TA:IIA or TA:III, as the case may be, and any other instruction or directive given by the relevant Treasury in respect of the Project concerned.

(F) **Terminology**

Unless the context requires otherwise, all terms used in this Standardisation that are defined in Regulation 16.1 of the Treasury Regulations shall have the meanings as defined in the Treasury Regulations.

GLOSSARY

The following acronyms are used in this Standardisation:

ECA	Environmental Conservation Act, 1973
EIA	Environmental Impact Assessment
DEAT	National Department of Environmental Affairs and Tourism
HDE	Historically Disadvantaged Entity
HDI	Historically Disadvantaged Individual
IDP	Integrated Development Plan
IRR	Internal Rate of Return
JIBAR	Johannesburg Inter-bank Agreed Rate
MAGA	Material Adverse Government Action
NEMA	The National Environmental Management Act, 1998
NPV	Net Present Value
O&M	Operations and Maintenance
PFMA	Public Finance Management Act, 1999
PPP	Public Private Partnership
PPPU	Public Private Partnership Unit of the National Treasury
RFP	Request for Proposals
ROI	Return on Investment
SAHRA	South African Heritage Resources Agency
SANRAL	South African National Roads Agency Limited
SARS	South African Revenue Service
SMME	Small, Medium and Micro Enterprises
SPV	Special Purpose Vehicle
STC	Secondary Tax on Companies
TA:I	Treasury Approval: I
TA:IIA	Treasury Approval: IIA
TA:IIB	Treasury Approval: IIB
TA:III	Treasury Approval: III
VAT	Value Added Tax

PART A: PRELIMINARY

1 DEFINITIONS

The following definitions are used in this Standardisation, unless otherwise stated, and should, where appropriate, be incorporated in the definitions clause of the PPP agreement.

Standard Definitions

Definitions

In this Agreement, unless the context otherwise requires, the following capitalised terms shall have the corresponding meanings:

"Affiliate"	*in relation to any person, any holding company or subsidiary of that person or any subsidiary of such holding company and "holding company" and "subsidiary" shall have the meanings assigned to them in the Companies Act, 1973;*
"Agreement"	*this public private partnership agreement between the Parties, being a public private partnership agreement as contemplated in Regulation 16 of the Treasury Regulations promulgated under the Public Finance Management Act, 1999;*
"Agreed Form"	*in relation to any document not executed simultaneously with this Agreement, the terms and conditions of that document have been agreed by the Parties and initialled by each of them for identification purposes on or before the Signature Date;*[12]
"Availability Certificate"	*means the certificate to be issued by the Private Party certifying that the Services are available;*
"Building Subcontract"	*the contract between the Private Party and the Building Subcontractor in respect of the design and construction Works;*
"Building Subcontractor"	*[x], being the person appointed by the Private Party to undertake the design and construction Works;*[13]
"Business Day"	*any day except a Saturday, Sunday or public holiday in the Republic of South Africa;*

[12] It is preferable to have all the Project Documents signed simultaneously. To the extent that this is not possible, the concept of "Agreed Form" should be used.

[13] Insert the name of the applicable person. For PPP projects that do not involve construction works (for example, some IT projects) other appropriate language should be used.

"Capital Expenditure"	*any expenditure treated as capital expenditure under GAAP;*
"Change in Law"	*has the meaning set forth in Clause [x];*[14]
"Compensation Events"	*has the meaning set forth in Clause [x];*[15]
"Completion Certificate"	*means the certificate to be issued by the Independent Certifier, declaring that the Works have been completed, in accordance with Clause [x];*[16]
"Completion Date"	*the date when the Works have been certified as complete by the issuing of the Completion Certificate;*
"Consents"	*all consents, permits, clearances, authorisations, approvals, rulings, exemptions, registrations, filings, decisions, licences, required to be issued by or made with any Responsible Authority for the performance of any of the Project Deliverables;*[17]
["CPIX"	*the consumer price index excluding interest on mortgage bonds, for metropolitan and other urban areas (Base 2000=100) published from time to time by Statistics SA in Statistical Release PO141.1; provided that if:* *(a) such index ceases to be published; or* *(b) the Institution and the Private Party agree (or, failing agreement, if it is determined by the Independent Expert) that due to a change in circumstances such index is no longer representative, then from the date when the index was last published, the Parties shall use such other index as agreed between them or, failing agreement, as determined by the Independent Expert as being a fair and reasonable replacement index;]*[18]
"Debt"	*at any date, all amounts due and payable by the Private Party that are outstanding under the Financing Agreements at that date, but excluding all default interest,*

[14] See Part K: (*Changes in Law and Variations*).

[15] See Part J: *(Relief Events, Compensation Events and Force Majeure)*.

[16] See Part E: *(Duration and Service Commencement)*.

[17] This excludes any third party consents from non-governmental authorities.

[18] See Part H:37.2.4 (*Payment and Financial Matters*).

	breakage premia as well as all fees, costs and expenses whatsoever in connection with any hedging arrangements entered into by the Private Party;[19]
"Default Interest Rate"	*[x];*[20]
"Direct Agreement"	*the agreement so titled between the Lenders (or their nominated agent), the Private Party and the Institution concluded simultaneously herewith or in the Agreed Form;*[21]
"Discriminatory Change in Law"	*has the meaning set forth in Clause [x];*[22]
"Equity"	*the entire issued share capital of the Private Party;*[23]
"Expiry Date"	*the [x]th anniversary of the Signature Date;*[24]
"Facilities"	*[the buildings and other facilities together with all supporting infrastructure, plant and equipment] as required to enable the Private Party to exercise its rights and perform its obligations included in the Project Deliverables;*[25]
"Final Bond"	*has the meaning set forth in Clause [x];*[26]
"Financial Model"	*means the financial base case for the Project as reflected in the computer model for the Project, a copy of which is attached to this Agreement on disk as Schedule [x], which model incorporates the forecast cash flow statements of the Private Party including all expenditure, revenues, taxation and financing of the Project Deliverables together with the income statements and balance sheets for the Private Party over the Project Term, and details of all assumptions, calculations and methodology used in the compilation*

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19 This definition also excludes Shareholder Loans.

20 This is the interest rate at which all overdue Unitary Payments and other overdue amounts under the Agreement will attract interest. This will usually be the base rate for example, JIBAR plus a "punitive" margin as specified. This should be established on a project-by-project basis.

21 See Part O:73 (*Step-In: By the Lenders*).

22 See Part K: (*Changes in Law and Variations*).

23 This definition excludes Shareholder Loans.

24 This Standardisation requires that the Agreement comes into effect at the Signature Date and that its effectiveness will not be subject to the fulfilment of suspensive conditions. Accordingly, the term "effective date", to the extent that it signifies a date later than the Signature Date upon which the Agreement comes into effect (pending fulfilment of suspensive conditions), is not used in this Standardisation.

25 This definition will be project-specific. The definition used here is appropriate for a hospital, head office or school accommodation project.

26 See Part F:32.6 (Maintenance in General: Security for Final Maintenance Obligations).

	thereof, as amended from time to time in accordance with this Agreement;
"Financing Agreements"	*the agreements relating to the Debt listed in Schedule [x] in their form as at the Signature Date and excluding all amendments thereto not approved in advance by the Institution;*[27]
"Force Majeure"	*has the meaning set forth in Clause [x];*[28]
"GAAP"	*generally accepted accounting practice in the Republic of South Africa as approved from time to time by the South African Accounting Practices Board;*
"General Changes in Law"	*has the meaning set forth in Clause [x];*[29]
"Good Industry Practice"	*using in relation to the manner in which the Services are provided, standards, practices, methods and procedures conforming to applicable law and exercising that degree of skill, care, diligence, prudence and foresight that would reasonably and ordinarily be expected from a skilled and experienced person engaged in a similar type of undertaking under similar circumstances;*[30]
"Historically Disadvantaged Entity"	*a sole proprietorship, partnership, company, close corporation or entity which is registered with the South African Revenue Services and which conducts an enterprise for profit capable of providing a commercially viable function; and (i) which enterprise is at least 50% beneficially owned and controlled (directly and indirectly) by one or more HDIs; and (ii) whose management and daily business*

[27] In the case of the Debt, the Financing Agreements usually include a loan facility or credit agreement and security documents (such as cessions in security over the bank accounts of the Private Party).

Given the Institution's potential liability on termination of the Agreement for the Debt, the Equity and the Shareholders Loans, it is essential that the Institution conducts a careful due diligence of the Financing Agreements and the Shareholders Agreement to establish the amounts comprising the Debt, the Equity and the Shareholder Loans and, in particular, to ensure that the Financing Agreements and Shareholders Agreement do not include amounts that are unusual or otherwise not market-standard. In this regard, see Part B:4.2 (*Due Diligence*). All amounts over and above outstanding capital and interest, such as default interest and breakage (or unwinding) fees, penalties, premia and costs, will have to be considered. Consideration will also have to be given to the inclusion of the cost of any interest rate hedging arrangements, where the interest rate on any financing made available for the Project is a variable rate (such as JIBAR).

Further, it is essential that if the Agreement provides for the Institution to pay any part of the Debt following termination of the Agreement, then any amount included in the Debt that an Institution is not willing to pay must be excluded from the definition of "Debt" in the Agreement.

[28] Part J:48 *(Force Majeure)*.

[29] See Part K: (*Changes in Law and Variation*).

[30] Good Industry Practice relates to that manner in which the Services are provided and not to the nature or scope of the Services, which should be clearly detailed in the Agreement. Also, depending on the project, it may be appropriate to limit Good Industry Practice to the standards, practices, methods and procedures used in the Republic of South Africa. In other projects, it may be advisable for Good Industry Practice to be determined with reference to international standards. The Institution should ensure that the geographical scope of these standards is the same for other PPP projects in the same sector. The Institution should seek specific advice on this issue from its technical advisers before the commencement of the procurement phase of the Project. To the extent that benchmarking can be achieved against objective standards, this should be done.

	operations are in the control of one or more HDIs;
"Historically Disadvantaged Individual"	*a person from any "designated group" as defined in the Employment Equity Act, 1998;*
"Independent Certifier"	*the independent certifier appointed by the Parties pursuant to Clause [x]*[31] *and who is responsible for issuing the Completion Certificate declaring that the Works have been completed;*[32]
"Independent Expert"	*[x];*[33]
"Institution"	*[x];*[34]
"Institution Assets"	*any assets and rights made available by the Institution to the Private Party for use in the Project Deliverables, including the Project Site;*[35]
"Institution Default"	*has the meaning set forth in Clause [x];*[36]
"Intellectual Property"	*all intellectual property rights whatsoever developed or acquired from time to time to [design, construct, develop, install, commission, operate and/or maintain] the Project whether capable of registration, registered or not (but excluding the Licensed Intellectual Property);*
"Lenders"	*any person providing financing to the Private Party under the Financing Agreements;*
"Licensed Intellectual Property"	*all intellectual property acquired by the Private Party under license from any third party and used in connection with the Project;*
"Long Stop Date"	*[[x], being the date by which the Services must have commenced, failing which the Institution shall be entitled to terminate the*

31 See Part E: *(Duration and Service Commencement)*.

32 The role of the Independent Certifier is separate from that of the Institution's own technical advisers (who assist in the technical review of proposals during the procurement phase of a Project) and also from that of the Independent Experts (who, in specified instances, are responsible for adjudicating certain disputes between the Parties - these are usually disputes relating to technical issues requiring fast-track resolution, which is not always possible using the ordinary dispute resolution procedures). The Independent Certifier is responsible for overseeing the construction or development works and for certifying completion of these works. See Part E:19 (*Duration and Service Commencement: Independent Certifier*).

33 Depending on the particular PPP project under consideration there may be a need for several Independent Experts (with expertise in different areas, such as IT, finance, civil engineering and socio-economic matters) to determine disputes arising under the Agreement on a fast-track basis. The Agreement should clearly stipulate which disputes are to be determined by which Independent Expert.

The definition must distinguish between the different Independent Experts required for a PPP project.

34 Insert the name of the Institution procuring the PPP.

35 This definition anticipates that these assets may not necessarily be "owned" by the Institution itself. In this regard, see Part D: (*Project Site*).

36 Part N: (T*ermination*).

	Agreement in accordance with the provisions in Clause [x]];[37]
"Net Cash Flow"	*at any date:* *(a) all revenues of an income nature received by the Private Party at that date; plus* *(b) all amounts drawn down by the Private Party under the Financing Agreements at that date; less* *(c) all expenditure of the Private Party at that date in relation to the Project Deliverables (excluding interest);*
"Operations Subcontract"	*the contract between the Private Party and the Operations Subcontractor in respect of the Services;*
"Operations Subcontractor"	*[x], being the person appointed by the Private Party to perform the Services;*[38]
"Parties"	*the Private Party and the Institution;*
"Penalty Deductions"	*has the meaning assigned thereto in Schedule [x];*[39]
"Penalty Points"	*has the meaning assigned thereto in Schedule [x];*[40]
"Private Party"	*[x];*[41]
"Private Party Default"	*has the meaning set forth in Clause [x];*[42]
"Project"	*[x];*[43]
"Project Assets"	*all assets and rights as required [to design, construct, develop, install, commission, operate and/or maintain the Project including the Facilities, any books and records, any spare parts and tools and contractual rights], as well as the*

37 See Part N:59 (*Termination: Causes of Termination*) This is a fixed date by which the provision of the Services must commence failing which the Institution will terminate the Agreement. Whether the use of a Long Stop Date is appropriate depends on the sector and on the specific circumstances of a PPP project. In this regard, see Part E:21 *(Security against late Service Commencement)*. The Long Stop Date should be significantly later than the Scheduled Completion Date in order to avoid hair-trigger termination.

38 Insert the name of the applicable person.

39 A detailed schedule regarding the payment mechanism must be prepared. It must include clear definitions of this concept and "Penalty Points", and details of how these will be calculated. The definition should cross refer to that Schedule. See also Part H: (*Payment and Financial Matters)*.

40 See above and also Part H: (*Payment and Financial Matters)*.

41 Insert the name of the Private Party to the Agreement.

42 See Part N: (*Termination*).

43 This term should be defined on a project-specific basis.

	Intellectual Property and the Institution Assets, but excluding all cash;[44]
"Project Deliverables"	*the carrying out of the Works, the carrying out of the commissioning and maintenance of the Project Assets including the renewal or replacement thereof, the management and provision of the Services and the exercise and performance of all other rights and obligations of the Private Party under this Agreement from time to time;*
"Project Documents"	*the Financing Agreements, the Shareholders Agreement, the Subcontracts and all other agreements described in Schedule [x]*[45] *relating to the performance of the Project Deliverables, each executed by the parties thereto simultaneously with this Agreement or otherwise in the Agreed Form;*
"Project Officer"	*the official designated by the [accounting officer / accounting authority] of the Institution on notice to the Private Party as the project officer for the Project. The Institution may replace the project officer from time to time on prior written notice to the Private Party;*[46]
"Project Site"	*the [land made available by the Institution to the Private Party] for the conduct of the Project Deliverables as further described in Schedule [x];*[47]
"Project Site Agreement"	*the agreement between the Parties in connection with the Project Site attached hereto as Schedule [x];*
"Project Term"	*the period from the Signature Date to the Expiry Date or the Termination Date, whichever occurs first;*

44 This definition will be project-specific and thus appropriate amendments should be made. In so far as Institution Assets are included in this definition, bidders should include as part of their due diligence in the bid phase of a Project a detailed analysis of the condition, life expectancy and maintenance and replacement cycle of such equipment.

45 These will include the agreements appointing any Independent Experts and any other subcontractors appointed directly by the Private Party (so-called "first-tier" subcontractors) but not the subcontracts between these first-tier subcontractors and their subcontractors (so-called "second tier" subcontractors).

The Private Party should be obliged under the Agreement to identify all Project Documents which are necessary for it to be able to perform the Project Deliverables. The list should (in this sense) be a "closed list".

46 The appointment of project officers for PPP projects is prescribed in terms of Treasury Regulation 16.8. Institutions should refer to the Contract Management Guidance for guidance on the role of project officers.

47 This definition applies to infrastructure projects for the construction of Facilities where the state usually owns the land on which the Facilities are to be constructed. This definition does not presume, however, that the Institution that is procuring the Project Deliverables will itself own the land. For instance, the land could be owned by another organ of state and leased or otherwise made available to the Institution. If an Institution intends to use land falling under the control of another institution in a PPP project, the Institution should endeavour to resolve all inter-governmental matters regarding the control of the land in question at the time of its application for TA:I. In this regard, see Part D: (*Project Site*).

Since the definition of "Project Site" is project-specific, appropriate amendments will have to be made.

"Refinancing"	*has the meaning set forth in Clause [x];*[48]
"Related Party"	*any Affiliate of the Private Party and its shareholders;*
"Relevant Change in Law"	*has the meaning set forth in Clause [x];*[49]
"Relief Event"	*has the meaning assigned thereto in Clause [x];*[50]
"Responsible Authority"	*any ministry, any minister, any organ of state, any official in the public administration or any other governmental or regulatory department, commission, institution, entity, service utility, board, agency, instrumentality or authority (in each case, whether national, provincial or municipal) or any court, each having jurisdiction over the matter in question;*
"Scheduled Service Commencement Date"	*the date stipulated in the Works programme as the date on which the Works are scheduled to be complete and the Services due to commence;*
"Service Commencement"	*the actual commencement of the Services, subsequent to the issue of the Availability Certificate in accordance with Clause [x];*[51]
"Service Commencement Date"	*the date of Service Commencement as stated in the Availability Certificate issued by the Private Party in accordance with Clause [x];*[52]
"Service Period"	*the period from the Service Commencement Date to the Expiry Date, unless the Agreement is terminated earlier in accordance with its terms;*
"Services"	*the operational services to be provided and/or procured by the Private Party for the Institution as set forth in Schedule [x], as may be subsequently amended in accordance with this Agreement;*[53]

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48 Part Q: (*Refinancing*).

49 Part K: *(Changes in Law and Variations)*.

50 Part J:46 (*Relief Events*).

51 Part E: (*Duration and Service Commencement*).

52 Part E: (*Duration and Service Commencement*). This date is critical for the purposes of establishing the commencement of payment of the Unitary Payments, the duration of the Service Period and the implications of early or late Service Commencement.

This Standardisation assumes that there is a single Service Commencement Date, but this may not always be appropriate. In some PPP projects, in particular, toll road projects, the commencement of the Services may occur in phases as different sections of the road are commissioned at different times.

Ideally, the Institution should not use the Facilities prior to the issuing of the Availability Certificate. To the extent that this is unavoidable, the Agreement should clearly stipulate that such use should not be deemed to constitute "acceptance" by the Institution nor should it relieve the Private Party from its obligations to satisfactorily complete the Works.

53 This refers to the operating rights and obligations of the Private Party to be delivered during the Service Period. The specific nature of the Services required is project-specific.

"Shareholder Loans"	*at any date, in relation to any financing (other than the Equity and the financing under a Financing Agreement) made available for the Project by the Shareholders, all principal unpaid at that date;*
"Shareholders"	*the holders of the Equity;*
"Shareholders Agreement"	*the agreement/s between the Shareholders and/or the Private Party in respect of the Equity and/or Shareholder Loans;*
"Signature Date"	*the date of signature of this Agreement by the last signing Party;*
"Subcontracts"	*the Building Subcontract and the Operations Subcontract;*[54]
"Subcontractor Costs"	*all damages, losses, liabilities, costs, and expenses (including legal costs and expenses) ("Losses") that have been or will be reasonably and properly incurred by the Private Party as a direct result of the termination of this Agreement, but only to the extent that:*

(a) the Losses are incurred in connection with the provision of Services or the completion of the Works, including:

(i) any materials or goods ordered or subcontracts placed that cannot be cancelled without such Losses being incurred;

(ii) any expenditure incurred in anticipation of the provision of the Services or the completion of Works;

(iii) the cost of demobilisation including the cost of any relocation of equipment used in connection with the Project; and

(iv) retrenchment payments; and

(b) the Losses are incurred under arrangements and/or agreements that are consistent with terms that have been entered into in the ordinary course of business and on reasonable commercial terms; and

54 This definition is limited to the first-tier subcontractors.

	(c) each of the Private Party and the relevant Subcontractor has used reasonable endeavours to mitigate its Losses;
"Subcontractors"	*the counter-parties of the Private Party to the Subcontracts including the Building Subcontractor and the Operations Subcontractor;*[55]
"STC"	*secondary tax on companies or any similar tax, which is imposed in place of or in addition to such tax;*
"Tax"	*any present or future tax, levy, impost, duty, charge, fee, deduction or withholding in the nature of a tax, under whatever name, imposed, levied or assessed by any Responsible Authority including, without limitation any interest, penalty, fine or surcharge in connection with any failure to pay or delay in paying of any of the aforesaid;*
"Termination Date"	*any date of early termination of this Agreement in accordance with its terms;*
"Unitary Payments"	*the charges payable to the Private Party in connection with the performance of its obligations included in the Project Deliverables as calculated in accordance with Clause [x];*[56]
"Variations"	*any variations to the Project Deliverables in accordance with Clause [x];*[57]
"VAT"	*any value added tax or any similar tax which is imposed in place of or in addition to such tax; and*
"Works"	*the [design, construction and installation] works to be undertaken by the Private Party as detailed in Schedule [x].*[58]

[55] This should only include first-tier subcontractors and not any subcontractors of the first-tier subcontractors. See also footnote 336.

[56] Part H: (*Payment and Financial Matters)*. The consideration payable to the Private Party for the Project Deliverables may be in the form of a fee payable by the Institution, or the collection by the Private Party of user charges deriving from the provision of the Services to users other than the Institution (for example, tolls payable by toll road users). See Part H: (*Payment and Financial Matters*). Appropriate amendments will have to be made in the relevant PPP agreement where the latter is the case.

[57] Part K: (*Changes in Law and Variations*).

[58] A detailed Schedule setting out the scope and standards of the construction (or development) works must be prepared and attached to the Agreement.

2 INTERPRETATION

The Agreement should include provisions setting forth the agreed principles that will govern the interpretation of the language, definitions and other terms used in the Agreement.

Standard Clause

Interpretation

This Agreement shall be interpreted according to the following provisions, unless the context requires otherwise:

(a) References to the provisions of any law shall include such provisions as amended, re-enacted or consolidated from time to time in so far as such amendment, re-enactment or consolidation applies or is capable of applying to any transaction entered into under this Agreement.

(b) References to "indexed to [CPIX]" in relation to any amount of money shall mean that such amount has been expressed in [month and year in which the Signature Date occurs] prices and shall be escalated annually as of the Signature Date and each anniversary thereof with reference to the then most recent publication of the [CPIX], subject to adjustments for any rebasing or recalculation thereof in accordance with the formula contained in Schedule [x].

(c) References to "Parties" shall include the Parties' respective successors-in-title and, if permitted in this Agreement, their respective cessionaries and assignees.

(d) References to a "person" shall include an individual, firm, company, corporation, juristic person, Responsible Authority, and any trust, organisation, association or partnership, whether or not having separate legal personality.

(e) References to any "Responsible Authority" or any public or professional organisation shall include a reference to any of its successors or any organisation or entity, which takes over its functions or responsibilities.

(f) References to "Clauses", "Sub-Clauses" and "Schedules" are references to the Clauses, sub-Clauses and schedules of this Agreement.

(g) The headings of Clauses, Sub-Clauses and Schedules are included for convenience only and shall not affect the interpretation of this Agreement.

(h) The Schedules to this Agreement are an integral part of this Agreement and a reference to this Agreement shall include a reference to the Schedules.[59]

(i) The Parties acknowledge that each of them have had the opportunity to take legal advice concerning this Agreement, and agree that no provision or word

59 See Part B:5 (*Schedules to the Agreement*).

used in this Agreement shall be interpreted to the disadvantage of either Party because that Party was responsible for or participated in the preparation or drafting of this Agreement or any part of it.

(j) Words importing the singular number shall include the plural and vice versa, and words importing either gender or the neuter shall include both genders and the neuter.

(k) References to "this Agreement" shall include this Agreement as amended, varied, novated or substituted in writing from time to time.

(l) References to any other contract or document shall include (subject to all approvals required to be given pursuant to this Agreement for any amendment or variation to or novation or substitution of such contract or document) a reference to that contract or document as amended, varied, novated or substituted from time to time.

(m) General words preceded or followed by words such as "other" or "including" or "particularly" shall not be given a restrictive meaning because they are preceded or followed by particular examples intended to fall within the meaning of the general words.

3 CONDITIONS

3.1 The Standardisation assumes that the Signature Date and the date when the Agreement comes into full force and effect will be the same. In other words, it assumes that the coming into effect of the Agreement will not be suspended pending the fulfilment of conditions (so-called "suspensive conditions" or "conditions precedent"). It further assumes that where the Signature Date and the effective date correspond, the continued effectiveness of the Agreement will not be set aside following the occurrence of future conditions (so-called "resolutive conditions" or "conditions subsequent").[60]

3.2 This approach is preferred in order to minimise the risk that the Agreement will fail for non-fulfilment of conditions that could be managed otherwise by the Parties, for instance, by other mechanisms in the Agreement such as an extension in time and/or compensation.

3.3 Typically, conditions entail the obtaining of Consents such as planning and

[60] The Lenders will generally also require that their obligations to advance, from time to time, any funding under the Financing Agreements be subject to the fulfilment of several suspensive conditions including the obtaining of all Consents required for the commencement of the construction Works, for example environmental Consents such as a record of decision approving any environmental impact assessment ("**EIA**") as may be required under applicable environmental law. This should not, however, affect the Institution's determination of what (if any) suspensive conditions may be appropriate to suspend the coming into effect (as between the Institution and the Private Party) of the Agreement. Since the Debt funding will not be available for drawing by the Private Party until the conditions to drawing under the Financing Agreements have been fulfilled (or waived), the availability of the Equity funding and Shareholders Loans will be critical in the early mobilisation phase of a Project.

land-use consents and environmental approvals required to be issued by Responsible Authorities, other than the Institution itself, for the commencement and undertaking of the construction Works.

3.4 Any Treasury Approvals required pursuant to Regulation 16 from the relevant Treasury for the approval of a PPP must be obtained before the Signature Date of an Agreement.[61] Accordingly, these approvals should not become suspensive conditions to the enforceability of the Agreement.

3.5 All corporate approvals and Consents required for the incorporation of the Private Party and all resolutions of the board of directors and shareholders of the Private Party approving the Agreement and authorising the execution and performance of the Agreement should be obtained prior to the Signature Date of the Agreement. It is never appropriate for the Agreement's enforceability to be suspended pending the incorporation of the SPV and the taking of any necessary corporate action to authorise the execution and performance of it.[62]

3.6 In general, any Consents relating to the specific design, construction and installation requirements of the Works included in a Project (particularly, any planning and land use consent relating to the design parameters of the Works and any record of decision regarding the EIA) and to the Private Party's operating obligations included in the Project Deliverables should not be treated as suspensive conditions but as ordinary terms of the Agreement.[63] Since the Private Party bears the design and construction risks in the Project it should assume the responsibility for identifying and obtaining all such Consents, although the Institution should provide any reasonable assistance in this

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[61] It should be borne in mind that the Treasury Approval process provided for in the Treasury Regulations will not obviate other necessary approvals. As indicated elsewhere in this Standardisation, at the feasibility study stage of a PPP project, the accounting officer or accounting authority, as the case may be, of the Institution must describe the extent to which the institutional function or use of state property can *legally* be performed by a Private Party in terms of a PPP agreement. This description should entail, amongst other things, the identification of all necessary Consents. For example, any approval required pursuant to section 54(2)(b) of the PFMA, which obliges the accounting authority of a public entity listed in Schedule 3 to the PFMA to obtain, before that public entity concludes any transaction involving its participation in a "significant partnership", the approval of the executive authority (Minister or MEC, as the case may be) that is accountable for that public entity or in whose portfolio it falls.

[62] If any of the shareholders of the Private Party are non-residents, any exchange control Consent required by them should be obtained by the Signature Date. The Institution should not agree that the obtaining of these Consents be a suspensive condition of the Agreement.

[63] This is particularly the case if the Project Site is a greenfield site and the Private Party is not taking over existing infrastructure and Facilities. In this regard, see Part D: *(Project Site)*.

regard.[64] The Works programme should set aside adequate time for the obtaining of all necessary Consents.

3.7 The Parties should identify at the commencement of the negotiations of the Agreement any project-specific reasons why any Consents cannot be obtained before the Signature Date and, assuming that there are good reasons why such Consents can only be obtained after the Signature Date, whether there are alternative mechanisms (such as Relief Events or Compensation Events) to deal with delays in obtaining such Consents as opposed to setting aside the Agreement.[65]

3.8 For instance, Consents may be required pursuant to the Competition Act, 1998 to the extent that this Act is applicable to any of the transactions included in the Project. If this Act is applicable to a PPP project, the Institution and the Private Party should endeavour to approach the competition authorities as soon as practicable after the award of the tender to the Private Party so as to obtain any necessary approvals before the execution of the PPP agreement.

3.9 Also, depending on the nature of the relevant PPP project, other Consents may be required from, among others, sector-specific regulators. For example, in the case of national toll road projects, the Minister of Transport must act pursuant to his powers under The South African National Roads Agency Limited and National Roads Act, 1998.[66] The timing of any sector-specific Consent will usually depend on the requirements of the legislation applicable to the sector concerned.

3.10 If it is practicable and permissible in law for any necessary merger, sector-specific or other Consents to be obtained prior to the Signature Date, then the Institution should ensure that this is done and should not agree to any conditions (suspensive or resolutive) in relation to the procurement (or not) of

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[64] The Institution should only assume responsibility for obtaining those planning and environmental Consents that do not relate to the specific design, construction and installation requirements of a Project and that can be obtained at the feasibility phase of a Project or at least before the Project is put out to tender. In this regard, see Part D:13.1.1 and Part D:14.2 (*Project Site*).

[65] See Part J: *(Relief Events, Compensation Events and Force Majeure)*.

[66] That Act specifically regulates all agreements concluded by SANRAL (a public entity listed in Schedule 3 to the PFMA) with private parties for the operation, management, control and maintenance of a national toll road, and for the financing, planning, design, construction, maintenance or rehabilitation of a national road.

such Consents.

PART B: PROJECT DOCUMENTS AND PROJECT DELIVERABLES

4 PROJECT DOCUMENTS

4.1 Introduction

4.1.1 The Private Party should be obliged as a term of the Agreement to identify all Project Documents (in a schedule to the Agreement) that are necessary for it to be able to perform the Project Deliverables.[67]

4.1.2 The Institution must review and be satisfied with the terms and conditions of the final execution form of each Project Document, and the Parties should endeavour to ensure that each Project Document is executed by the parties thereto simultaneously with the Agreement. If this is not practicable, then the Institution should ensure that any Project Document not executed at the signing meeting for the Agreement is in final Agreed Form by the Signature Date. This is typically done by annexing the final Agreed Form as a schedule to the Agreement and by granting the Institution a right to pre-agree all amendments to the final Agreed Form.

4.1.3 Generally, any amendments to, or waivers of, any rights under any Project Document (to which the Institution is not a party) must be subject to prior notice to, and written agreement by, the Institution.[68] The only exceptions here are amendments to, or waivers under, the Financing Agreements that constitute or give effect to "Exempt Refinancings" or "Permitted Borrowings", each as defined in Part Q. However, even in the case of any proposed Exempt Refinancing, the Institution should ensure that the Agreement provides for the Private Party to notify the Institution in advance of that Exempt Refinancing.

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[67] The Project Documents typically include the Subcontracts, the agreements for the appointment of the Independent Certifier and any Independent Experts, the Financing Agreements, the Shareholders Agreement and the Project Site Agreement.

[68] If the Institution is a direct party to a Project Document or is expressly entitled to accept any rights arising under it for its own direct benefit (by way of a so-called "*stipulatio alteri*" or "stipulation in favour of another"), which will usually be the case in relation to agreement(s) for the appointment of any Independent Expert(s), then there will be no need to provide for a specific right in the Agreement for the Institution to limit the ability of the Private Party to agree on changes to any such Project Document since the Private Party would in any event not be able to do so without involving the Institution.

4.1.4 The Institution should not agree to any amendment of, or waiver under, any Project Document if such amendment or waiver may impact negatively on value for money, affordability, or the risk profile of the Project. If such amendment or waiver also entails an amendment to the Agreement itself that may be material, then the Institution may not agree to such amendment without the prior written approval of the relevant Treasury such approval will only be given if the Agreement, as amended, will continue to provide value for money, be affordable for the Institution and transfer appropriate risk to the Private Party.[69]

Standard Clause

Project Documents

(a) The Private Party must comply with the provisions of the Project Documents and, save as otherwise provided in relation to Exempt Refinancings or Permitted Borrowings, may only:

(i) terminate, or make any amendment to (or otherwise agree to do so) any Project Document; or

(ii) in any respect, depart from its obligations or waive any rights under any Project Document,

with the prior written agreement of the Institution.

(b) The Private Party shall procure that any Project Document not executed simultaneously with this Agreement is executed in the Agreed Form annexed to this Agreement.

(c) Without limiting the restrictions on amendments to the Project Documents in Clause (a) above, the Private Party shall furnish the Institution with a true and complete copy (including all annexes) of any amendment to any Project Document or of any Project Document not executed by the Signature Date, within [x] Business Days of the date of the Private Party's execution of such amendment or Project Document.[70]

4.2 Due Diligence

4.2.1 Introduction

4.2.1.1 Although the Institution should not seek to micro-manage the

[69] Treasury Regulation 16.9.

[70] Any Project Documents to be executed after the Signature Date should be disclosed in the Schedule to the Agreement listing the Project Documents, and should be in the Agreed Form.

implementation of the Project by a Private Party, it must nevertheless ensure that it understands how the Private Party intends to deliver the Project Deliverables in terms of its subcontracting and financing arrangements and be satisfied that those arrangements (as reflected in the relevant Project Documents) are adequate to allow the Private Party to deliver the Project Deliverables.

4.2.1.2 Accordingly, the Institution should (through its advisers) conduct a thorough ongoing due diligence on all the proposed Project Documents from the bid evaluation phase and during the negotiations with the successful bidder until their execution. This is essential for several reasons including the following:

(a) the amount of compensation payable to the Private Party on termination will, except in the case of a Private Party Default, take into account certain amounts (or a portion thereof) owed by the Private Party to the Lenders under the Financing Agreements. The Institution must review the Financing Agreements to establish how these amounts are calculated;[71]

(b) the amount of compensation payable to the Private Party may in certain circumstances (for example, an Institution Default) take into account Equity and/or Shareholder Loans. If so, the Institution should review the Shareholders Agreement to establish how the amounts included in it are calculated;[72]

(c) where the Institution relies on the requirements of the Lenders under the Financing Agreements for protection in relation to certain risks (for example, in the case of

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[71] See Part N: *(Termination)* for a description of the circumstances when the compensation payable to the Private Party upon termination will take Debt into account.

[72] See Part N: *(Termination)*.

maintenance risk, the Lenders' requirement for financial provisions for the ongoing maintenance of the Facilities through a maintenance reserve account or for ongoing asset replacement through an asset replacement account), the Institution should ensure that the terms of the Financing Agreements reflect the Institution's expectations;

(d) where the Institution seeks to retain the right to assume the Subcontracts in the event of the termination of the Agreement, the Institution should examine the terms of the Subcontracts to ensure that they permit such assumption. This is particularly important where the Institution wishes to ensure the continuity of service provision under the Subcontracts in circumstances where the Agreement is terminated and these Services are critical. Adequate provision for such rights in favour of the Institution in the Subcontracts themselves will avoid the need for direct agreements between the Institution and the Subcontractors;

(e) to ensure that the Financing Agreements and Shareholders Agreement are consistent with the agreed Financial Model; and

(f) to ensure that the Financing Agreements and the Shareholders Agreement are consistent with the provisions of the Agreement dealing with Refinancings.

4.2.1.3 The Institution (with the assistance of its insurance adviser) should also review the letters of the broker appointed to place the required insurances for the Project so as to ensure that the broker's undertakings referred to in Part I: (*Insurance*) are incorporated in them.

4.2.2 Financing Agreements and Shareholders Agreement

4.2.2.1 The Institution should require copies of the Financing Agreements and the Shareholders Agreement (in final Agreed Form, as these agreements are unlikely to be executed before the Signature Date of the Agreement) of the preferred bidder in advance of the Signature Date to allow it sufficient time to conduct its due diligence.

4.2.2.2 In the due diligence, the Institution should assess and seek advice from its advisers concerning, among other things:

(a) *interest margins* – in particular, whether these agreements make provision for changes in the margins on interest rates. Any changes in the margins should be consistent with those contemplated in the Financial Model;

(b) *fees and costs* – any (i) breakage (that is, unwinding) fees, penalties, premia and costs for early prepayment of the Debt; (ii) costs (including related breakage costs) relating to any hedging arrangements (including, among other things, any swaps, options, floors and caps) to mitigate against interest rate and foreign exchange fluctuations; (iii) commitment, underwriting, arrangement, structuring or other fees payable to the Lenders (or to the arrangers of the financing made available to the Private Party or to the Lenders' agents). If the termination compensation will include any fee, penalty, premium or cost as contemplated above, then the Institution must seek advice as to whether it (and the amount thereof) is market-standard, competitive and cost-effective and as to how it is calculated.[73] The Institution should also review all hedging arrangements in

[73] As regards which fees, penalties, premia and costs may be incorporated into the termination compensation, see Part N:63 *(Compensation: Termination for Institution Default),* Part N:64 *(Compensation: Termination for Convenience)* and Part N:65 *(Compensation: Termination on Force Majeure).*

respect of these costs to ensure that the Private Party has adequately hedged against its exposure to any interest rate and foreign exchange fluctuations;

(c) *maintenance and other reserves* – the Lenders' requirements in respect of the funding of any cash reserves to be put in place by the Private Party (including, for example, any maintenance reserve account or asset replacement account) and the levels required to be maintained in these reserves. The Institution should confirm that upon termination of the Agreement all these reserves will be applied in reduction of the amount of the Debt for the purpose of calculating the termination compensation (so that the Private Party and its funders will not obtain a double recovery) and, further, in the case of any Refinancing that the release of any of these reserves will be caught in the sharing mechanism;

(d) *intercreditor arrangements* – the intercreditor arrangements between the Lenders and/or the Shareholders should not undermine any principles agreed to in the Agreement, particularly in relation to the Agreement provisions concerning the payment and amount of any termination compensation;

(e) *letters of credit* – the Private Party's rights pursuant to the Financing Agreements to maintain reserves through the provision of letters of credit or to withdraw the proceeds of any reserve accounts and replace them with letters of credit should be considered. The Institution must ensure that (i) the benefits of any such letters of credit are taken into account in the calculation of any termination compensation and, in the case of any Refinancing, in the sharing of any gains deriving from that Refinancing, (ii) the amounts capable of being claimed under any letters of credit are set-off against the termination compensation to be paid by the Institution to the Private Party (so that the Private Party and its funders will not obtain a double recovery), and (iii) the letters of credit do not automatically terminate on termination of the Agreement (automatic termination will result in the Institution paying a higher compensation amount). Accordingly, the Institution should require a pre-agreed form of letter of credit to be used if the Financing Agreements require reserves to be maintained through the provision of letters of credit or permit reserve accounts to be replaced with letters of credit; and

(f) *empowerment arrangements* – the Shareholders Agreement should be reviewed for consistency with the obligations undertaken by the Private Party in its bid proposal and the Agreement in respect of any empowerment Equity, the involvement of HDIs in all aspects of the Project (particularly operations), skills transfer to HDIs and subcontracting arrangements with SMMEs. For instance, the Institution should obtain advice regarding whether the Shareholders Agreement provides adequate protection against the dilution of the minimum empowerment Equity required for the Project from time to time if any capital calls are made by the Private Party;[74]

(g) *Equity structure* – the shareholdings in the Private Party should be consistent with the ownership and control arrangements set out in the Private Party's bid proposal. Any security interests taken over the Equity (not limited to empowerment Equity) should be considered for their implications in relation to the share transfer restrictions in

[74] The authenticity of the ownership by HDIs of equity in all proposed HDE investors in the Private Party should be established at the bid evaluation phase and confirmed when the SPV is incorporated.

the Agreement (See Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*)); and

(h) *Security* – all security arrangements over any Project Assets (for example, any notarial bond and pledges over movables and any cessions in security over incorporeal assets) enjoyed by the Lenders and other third parties must be identified. The Institution must ensure that the Agreement makes adequate provision for all security over the Project Assets to be released at the end of the Project Term.

4.2.3 Subcontracts

4.2.3.1 Bearing in mind that the Private Party must bear the risks of subcontracting any part of the Project Deliverables and, further, that the provision of subcontracted services should reflect what is available in the market, the Institution should nevertheless review the Subcontracts prior to the Signature Date to ensure that what the Subcontractors will provide in terms of the Subcontracts is reasonably likely to meet the output specifications of the Agreement and that the price of any such Subcontract is consistent with the price for that subcontract set forth in the Financial Model.

4.2.3.2 The Institution's main concerns in relation to these first-tier subcontracts should be the following:

(a) *term of Operations Subcontract* – the term of this Subcontract should match the Service Period;

(b) *expertise, experience and responsibility* – since the Private Party is an SPV with no track record of service delivery, the Institution must be satisfied that each Subcontractor has the necessary expertise and experience to deliver the part of the Project Deliverables subcontracted to it.[75] The Institution must also satisfy itself that the subcontracts are consistent with the terms proposed in the Private Party's bid proposal and the Agreement, that they impose responsibility on each Subcontractor to perform its subcontracted obligations and that the Private Party has real recourse to each Subcontractor in the event that it defaults under its obligations in the subcontract. Here, the Institution should identify any limitations in the Subcontracts on the liabilities of Subcontractors to perform their obligations in terms of the Subcontracts;

(c) *replacement of Subcontractors* - the Institution must reserve the right in the Agreement to approve the selection of any replacement Subcontractors (first-tier only) applying the same criteria applied in the selection of the initial Subcontractors (such as appropriate expertise, experience and responsibility);

(d) *amendments to Subcontracts* – the Subcontracts should record that any amendments to those Subcontracts will require the prior written agreement of the Institution;

(e) *liquidated damages* – if the Agreement requires the Private Party to pay liquidated damages to the Institution for late delivery of any subcontracted Project Deliverables, then the Institution should ensure that these damages are payable out of amounts available under the relevant Subcontracts (subject to the claims of the Lenders). This is important because if the terms of the Agreement and Subcontracts are materially different, then the Institution could be exposed if the Private Party cannot claim from

[75] The expertise and experience of the Subcontractors should be established at the bid evaluation phase and confirmed when subcontracts are finalised.

the Subcontractor responsible for the relevant Project Deliverables.

5 SCHEDULES

5.1 PPP agreements usually include several attachments and annexures (referred to in the Agreement as “**Schedules**”).

5.2 These typically set out:

5.2.1 the Financial Model (usually in disk format);

5.2.2 the executed Project Documents or, if not executed by the Signature Date, the Agreed Forms of any such Project Documents;

5.2.3 the Institution’s output specifications (which will have formed part of the RFP);

5.2.4 the Private Party’s bid proposal (including all improvements to it as accepted by the Institution in the bid phase);

5.2.5 the Works Programme and Scope;

5.2.6 the Services to be provided or procured by the Private Party;

5.2.7 the Project Site description unless the description is included in a Project Site Agreement;

5.2.8 the list of any Institution Assets;

5.2.9 the payment mechanism including the definitions for “Penalty Points” and “Penalty Deductions”;

5.2.10 the formula for the rebasing or recalculation of CPIX;

5.2.11 the performance monitoring regime;

5.2.12 the Consents relating to the Project;

5.2.13 the list of the required insurances (including a statement of the material terms thereof) and the broker's letter confirming the placement of the required insurances;

5.2.14 the incorporation details of the Private Party (including copies of its certificate of incorporation and certificate to commence business) and its capital structure and shareholdings;

5.2.15 the prescribed form of Availability Certificate, the Completion Certificate and any other certificate provided for in the Agreement; and

5.2.16 the handback procedure.

6 PROJECT DELIVERABLES

6.1 The scope and extent of the Project Deliverables are project-specific and will be based on the specific strategic and operational objectives which the Institution wishes to attain as reflected in its required output specifications.

6.2 Although the operational risks, particularly the so-called "availability risk" (that is, the possibility that the Services are not available to meet the required output specifications of the Institution) resides with the Private Party and not the Institution, the successful implementation of this risk allocation is substantially dependent on the clarity of the required output specifications and the Parties' ability to co-operate in the implementation of the Project Deliverables. Accordingly, the Institution should ensure that the output specifications included in the RFP are clearly drafted and that the Agreement makes provision for co-operation.

Standard Clause

Project Deliverables

(a) *Private Party*

(i) *Subject to, and in accordance with, the provisions of this Agreement, the Private Party shall be entitled to exercise its rights and perform its obligations included in the Project Deliverables, at its own cost and risk without recourse to the Institution save as otherwise expressly provided for in this Agreement.*

(ii) *Without limiting Clause (i), the Private Party shall, at its own cost and risk, be solely responsible for procuring that the Project Deliverables are performed:*

(aa) *in accordance with Good Industry Practice;*

(bb) *in a manner that is not likely to cause death, injury to health or damage to property or the environment;*

(cc) *in a manner that is consistent with the Institution discharging its statutory functions and duties;*[76]

(dd) *in compliance with all applicable law and the Consents; and*

(ee) *in accordance with its bid proposal (a copy of which is attached hereto as Schedule [x]), save to the extent inconsistent with the aforesaid or an express obligation of the Private Party in the Agreement.*[77]

(b) *Co-operation*

Each Party shall co-operate with the other in the performance of their respective rights and obligations under this Agreement.

[76] This is particularly important in the case of hospital projects where clinical service provision by the Institution must not be hindered by the manner of conduct of the Project Deliverables.

[77] This does not obviate the need for the Parties to develop detailed schedules to be attached to the Agreement and which will cover the more technical aspects of the Project not included in the main body of the Agreement.

PART C: GENERAL OBLIGATIONS

7 GENERAL OBLIGATIONS AND RESPONSIBILITIES OF PRIVATE PARTY

7.1 As indicated above, it is assumed in this Standardisation that the Private Party will be an SPV and, accordingly, will not engage in any business or activities not included in the Project Deliverables. If, in a particular Project, the Private Party is entitled to engage in any non-project activities on the Project Site or to use any Project Assets, then the provisions of the Agreement dealing with its general obligations and responsibilities will have to be amended accordingly and, in particular, to ensure that the Project is not prejudiced (by the diversion of Project Assets or the non-availability of the Services) as a result of such non-project activities.

7.2 It is also assumed that the Private party will subcontract the Project Deliverables to the Subcontractors.

7.3 These assumptions are reflected in the following Standard Clause.

Standard Clause

General Obligations

(a) The Private Party shall not engage in any business or activity other than the business or activity included in, or otherwise required to enable the Private Party to provide, the Project Deliverables.

(b) The Private Party shall not be relieved of any obligation, responsibility or liability under this Agreement by the appointment of any Subcontractor to carry out any part of the Project Deliverables. As between the Private Party and the Institution, the Private Party shall be responsible for the payment, performance, acts, defaults, omissions, breaches and negligence of all Subcontractors. All references in this Agreement to any performance, payment, act, default, omission, breach or negligence of the Private Party shall be deemed to include any of the same by a Subcontractor.[78]

[78] This Standard Clause reflects the prescribed allocation of Subcontractor risk (that is, the risk of losses or damages arising as a result of defaults on the part of any Subcontractor or its insolvency) to the Private Party. The Private Party should, in turn, pass any risks associated with the performance of any part of the Project Deliverables by any Subcontractor down to the relevant Subcontractor. For instance, in the case of any design risks or completion risks to the Building Subcontractor and other "first-tier" construction Subcontractors (if any) such as the quantity surveyor by obtaining indemnities or some form of security such as construction guarantees or cessions in security of the proceeds of any insurance to be taken out by the Subcontractors. Notwithstanding this, prior to the Signature Date the Institution should satisfy itself following a review of the Subcontracts included in the Project Documents that the subcontractor risks are appropriately allocated as between the Private Party and the Subcontractors. See Part B: *(Project Documents and Deliverables)*.

8 WARRANTIES

8.1 Introduction

8.1.1 In this Standardisation, "warranty" is used to mean a statement confirming the truth of the matters mentioned in it as at the Signature Date. A breach of a warranty in the Agreement should not give rise to any right on the part of the defaulting Party to rescind or otherwise terminate the Agreement, save in the case of warranties relating to corrupt gifts.[79] Instead, a breach of warranty should give rise only to a claim for damages under the indemnity provisions of the Agreement (within the limits referred to herein and subject to an obligation on the part of the aggrieved Party to mitigate the consequences of the breach), save in the case of a breach of the warranties relating to corrupt gifts where termination is also permitted.[80]

8.1.2 The Private Party warranties in the Standard Clause below set out the minimum warranties that will ordinarily be sought by the Institution. The Institution should consider at the time when the RFP is being prepared and also at the bid evaluation phase whether any additional warranties should be sought.

8.1.3 The warranties (if any) to be given by an Institution must be justified on a project-specific basis. For instance, in the case of "information warranties", where the Institution is the only source of information and that information cannot be independently verified.

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[79] See Part S:86 (Miscellaneous: Corrupt Gifts).

[80] Although the concept of "warranty" is widely used and accepted in practice, it has no generally accepted meaning in South African law. Accordingly, contracting parties should always ensure that their contract clearly spells out what the intended purpose and effect of any "warranties" are, particularly if breached.

On the other hand, concepts such as "representation" (or, more correctly, its obverse "misrepresentation") and "term" when used in a contractual setting do have generally accepted legal meanings and their use in a contract usually permit specific remedies (including, rescission or cancellation), unless the contracting parties have agreed to vary the remedies ordinarily associated with these concepts.

To avoid confusion, the Standardisation prescribes the use of "warranty" over "representation" (and any other concepts such as "covenant", "undertaking", and so forth) when referring to any circumstances that exist or ought to exist as at the Signature Date (or any other specific date) and on which either Party is relying to be true as at that date, and further that the intended purpose and effect of any "warranty" be clearly spelt out (as stated in Part C:8.1) in the Agreement.

8.1.4 All warranties including information warranties given by an Institution, should be drafted with extreme care and limited appropriately.

8.1.5 Where the Institution is not the only source of any information, or that information can be independently verified, the Institution must not give any warranties regarding that information. Instead, the Private Party should be required to rely on the results of its due diligence on the information provided by the Institution, including any independent studies undertaken to verify that information. If no information warranties are to be given by the Institution, then the Agreement should expressly record this and, in addition, provide that the Private Party be solely responsible for identifying all information necessary for the performance of the Project Deliverables.

8.1.6 Warranties from either Party in relation to capacity and authority provide no real benefits since, if any such warranty is untrue, the remedies for breach of warranty in the Agreement will have no significance as the Agreement will not be capable of being enforced. Nevertheless, the Institution should warrant its capacity to enter into the Agreement and the authority of its accounting officer or accounting authority, as the case may be, to execute the Agreement on its behalf in order to provide the Private Party (and its funders) with some measure of comfort.

Standard Clause

Private Party Warranties

The Private Party warrants that:

(a) all the Project Documents have been executed and are in full force and effect as at the Signature Date, save for those Project Documents identified in Schedule [x] that will be executed in the Agreed Form after the Signature Date by the corresponding date in Schedule [x];[81]

(b) the execution and performance of any Project Documents do not and will not contravene any provision of the memorandum or

[81] As a general rule, the Institution should endeavour to ensure that all Project Documents are executed at the same time as the execution of the Agreement. If this is not practical, then the Institution must ensure that the Project Documents in question are in final Agreed Form by the Signature Date and, in any event, that the later execution of it will not delay the running of the Project Term.

articles of association of a Private Party[82] *as at the Signature Date, or any order or other decision of any court, Responsible Authority or arbitrator that is binding on the Private Party as at the Signature Date;*

(c) *all Consents required for the conduct of the Project Deliverables are in full force and effect as at the Signature Date, save for any Consents which are not required under applicable law to be obtained by the Signature Date; provided that the Private Party warrants that it knows of no reason (having made all reasonable enquiries in this regard) why any such Consent will not be granted on reasonable terms by the time it is required to obtain such Consent;*

(d) *no litigation, arbitration, investigation or administrative proceeding is in progress as at the Signature Date or, to the best of the knowledge of the Private Party as at the Signature Date having made all reasonable enquiries, threatened against it, which is likely to have a material adverse effect on the ability of the Private Party to conduct the Project Deliverables;*

(e) *the Private Party is not subject to any obligation, non-compliance with which is likely to have a material adverse effect on its ability to conduct the Project Deliverables;*

(f) *no proceeding or any other steps have been taken or, to the best of the knowledge of the Private Party having made all reasonable enquiries, threatened for the winding-up or liquidation (whether voluntary or involuntary, provisional or final), judicial management (whether provisional or final) or deregistration of the Private Party, or for the appointment of a liquidator, judicial manager or similar officer over it or over any of its assets;*

(g) *all information disclosed by or on behalf of the Private Party to the Institution at any time up to the Signature Date and, in particular, during the bid process preceding the award of this Agreement to the Private Party, is true, complete and accurate in all material respects and the Private Party is not aware of any material facts or circumstances not disclosed to the Institution which would, if disclosed, be likely to have an adverse effect on the Institution's decision (acting reasonably) to award the Agreement to the Private Party;*

(h) *the copies of the executed Project Documents, which have been delivered to the Institution, are true and complete copies of such Project Documents and there are no other documents replacing or relating to any such Project Documents, which would materially affect the performance of these Project Documents; and*

(i) *as at the Signature Date:*

82 Appropriate amendments will need to be made if the Private Party is not a company.

(i) the Private Party has an authorised and issued share capital as set out in Schedule [x] and all shares in the issued share capital of the Private Party are fully paid up;

(ii) all shares in the issued share capital of the Private Party are legally and beneficially owned as represented in Schedule [x];

(iii) save as provided in the Financing Agreements or the Shareholders' Agreement, no person has the right (whether actual or contingent) to call for the issue of any share or loan capital in the Private Party whether pursuant to any option or otherwise including on realisation of security; and

(iv) save as provided in the Financing Agreements or Shareholder Loan agreements, there is no encumbrance over or affecting any of the Equity or the Shareholder Loans and there is no agreement or commitment to grant or create any such encumbrance.[83]

Institution Warranties

The Institution warrants that it has taken all necessary actions to authorise the execution of this Agreement.

8.2 Institution Warranties and Existing Services (Latent Defects)

8.2.1 The following commentary deals with the specific issue of Institution warranties where existing Facilities and Services are taken over by the Private Party.

8.2.2 Bidders base their bids and, in particular, their proposed pricing of the Project Deliverables on the information provided by the Institution in the RFP and other procurement documentation. If the information so provided is capable of being verified from sources other than the Institution such as independent investigations, then the Institution should not assume the risk of the information being inaccurate.[84] If the Institution's information is not capable of being independently verified, then the Private Party may not be willing to assume that risk.

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83 See also the Standard Clause on corrupt gifts in Part S:86 (*Miscellaneous: Corrupt Gifts*) which includes warranties relating to corruption.

84 Institutions should generally arrange, prior to commencement of the procurement process for a PPP, for the appointment of independent third party consultants to conduct investigations to verify the information made available by the Institution and for the reports by such consultants on such investigations to be made available to all bidders. The costs (or estimates thereof) of these investigations should be disclosed in the affordability assessment included in the feasibility study accompanying the application for TA:I.

8.2.3 If the Project entails the transfer of Institution Assets to the Private Party, particularly existing infrastructure and Facilities (so-called "brownfield projects") which require substantial refurbishment and repair, the Private Party will be unlikely to agree to assume any risk of latent defects in the Institution Assets and will probably require warranties from the Institution as to the condition of the Institution Assets. This is particularly the case in the situation where existing infrastructure was constructed and operated according to out-of-date building and environmental standards.

8.2.4 If the Agreement requires the transfer of employees of the Institution to the Private Party, the Private Party will probably require Institution warranties regarding the scope of any pre-Agreement liabilities for pensions and other employment benefits, given that these liabilities are not always capable of accurate calculation and given the legal protections afforded to employees as against new employers.[85]

8.2.5 The Institution should consider that a blanket refusal to give any of the above warranties might discourage the submission of bids and thereby reduce the competitiveness of the tender, or might result in bid prices that impact negatively on the required affordability and value for money levels of the proposed PPP project. The Institution should always consider whether it can obtain better value for money (taking into account the overall risk allocation of the PPP project) if it is able to give these warranties. The Institution should, however, be careful that its warranties do not extend beyond what is reasonable in the circumstances.

8.2.6 Furthermore, the Institution should not provide warranties in respect of risks that are covered by the required insurances which the Private Party is obliged to procure.

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[85] This is because of the statutory liabilities imposed on new employers pursuant to section 197 of the Labour Relations Act, 1995. This section provides that where a business is transferred as a "going concern" the rights and obligations of the employees as against the old employer (the "transferor") are *automatically* assumed by the new employer ("transferee"), which as between it and the transferring employees effectively steps into the shoes of the transferor. Therefore, by operation of law, the transferee assumes *all* liabilities of the transferor under employment contracts in respect if any period preceding the transfer date. The particular exposure of the transferee here is in connection with the pension and benefit rights of transferring employees which form part of the cost of employment and therefore are automatically assumed by the transferee pursuant to section 197. In this regard, See Part L (*Employment*).

9 INDEMNITIES AND CLAIMS FOR DAMAGES

9.1 The Institution will want to ensure that the Agreement requires the Private Party to indemnify the Institution against certain losses, particularly in respect of any third party claims in connection with the Private Party's conduct of the Project Deliverables, and as such the Private Party will usually make provision for such contingent liability in its bid price to the extent that it is not covered by insurance.[86]

9.2 Generally, there are five heads of liability against which the Institution should seek to be indemnified. These are:

9.2.1 death and personal injury;

9.2.2 property damage;

9.2.3 breach of statutory duty;

9.2.4 third party claims; and

9.2.5 breach of a Private Party warranty.

9.3 As a general rule, the Institution should not agree to any exemption from, or any monetary limit ("**cap**") on, the Private Party's liability under any such indemnity.

9.4 This is particularly so in the case of indemnified third party claims since the Private Party will in any event be exposed to the full extent of any such claim should the third party choose to sue the Private Party directly. The Institution should carefully consider, having regard to the nature of the Project, whether there is a substantial likelihood of third party claims and whether these claims can be adequately covered by insurance (particular consideration should be given to the likelihood of third party claims for consequential losses). If there is a high risk of substantial third party claims that may not be adequately

[86] The term "indemnity" as used in this Standardisation means an undertaking on the part of the indemnifying party (acting as principal) to compensate or reimburse the indemnified party for certain losses arising in connection with the conduct (whether an act or omission) of the indemnifying party such as a breach of any contractual provision or a breach of any warranty given by it.

covered by insurance, then a cap should not be agreed unless this has a substantially negative impact on the affordability of (through increased Unitary Payments), and value for money required to be provided by, the Project.

9.5 In relation to the Private Party's indemnities in favour of the Institution that cover losses incurred by the Institution not based on third party claims, (for instance, indemnities for losses arising from damage to Institution Assets), the Institution should agree to a cap on such indemnities if an unlimited liability under such indemnities will substantially increase the cost of, and limit the value for money provided by, a PPP project.

9.6 The Private Party will, in turn, expect the Institution to grant indemnities to the Private Party for losses sustained by the Private Party as a result of certain conduct by the Institution or the breach of any Institution warranties (if any). The Institution should carefully consider, having regard to the nature of the Project, whether there are any circumstances in which the Institution could conceivably cause any losses to the Private Party. Whatever these circumstances may be, no indemnities should be given by an Institution where the underlying risks in respect of which indemnification is sought may be mitigated by any insurance cover which the Private Party is required to maintain pursuant to the Agreement, or where the Agreement will provide other compensation to the Private Party for the losses incurred by it in any such circumstances. If there are any exceptional circumstances justifying the giving of indemnities by the Institution, these must be carefully drafted[87] and, if this will ensure value for money, be subject to caps.[88]

9.7 Care should be taken to ensure that any losses indemnified by the Institution are limited to the direct losses of the Private Party, and that all indirect losses of the Private Party, such as loss of profits, loss of use, loss of production, loss of business, loss of business opportunity or consequential loss, are expressly

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[87] The indemnities should clearly exclude any liability on the part of the Institution to the extent caused by the negligence or wilful misconduct of the Private Party.

[88] The Institution should also obtain legal advice regarding its capacity and authority to grant any indemnities in light of the provisions of chapter 8 of the PFMA.

excluded. The same principle applies in relation to losses of the Institution indemnified by the Private Party, in other words, the Institution's indirect losses should generally be excluded. This principle, however, does not apply to third party consequential losses. In the case of any indemnified third party claims which may include third party consequential losses, the Institution should consider on a project-by-project basis whether or not it may be appropriate (having regard to value for money considerations) to exclude third party consequential losses from the losses covered by the indemnities provided in the Agreement (whether by the Institution or the Private Party).

Standard Clause

Indemnities

The Private Party shall indemnify and keep the Institution indemnified at all times from and against all direct losses sustained by the Institution in consequence of:[89]

(a) any:

(i) claim for or in respect of the death or personal injury of any individual;

(ii) loss of or damage to property (including, without limitation, any Institution Assets); or

(iii) breach of a statutory duty arising under applicable law,

(including, without limitation, any legal costs) arising in connection with the performance or non-performance of any Project Deliverables, save to the extent caused by the [gross negligence or][90] *wilful misconduct of the Institution or by a breach by the Institution of an express provision of this Agreement; or*

(b) any breach by the Private Party of any warranties given by it in this Agreement.

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89 If because of value for money considerations any consequential losses included in any third party claims are to be excluded from the cover provided by these Private Party indemnities, then the reference to "direct losses" should be appropriately qualified.

90 These Private Party indemnities apply even if the indemnified loss is caused by the negligence of the Institution on the assumption that insurance cover will be available to cover the underlying risks. Depending on the availability of insurance cover and the value for money of such cover, gross negligence on the part of the Institution should also be covered by the indemnity and excluded from the exception.

9.8 With regard to any indemnified third party claim, the Agreement should set forth provisions governing the conduct of such claims, pursuant to which:

9.8.1 the indemnifier will be obliged to notify the indemnified of any such claim within a specified period of the indemnifier obtaining any actual knowledge of it;

9.8.2 subject to the terms of any required insurance policy, the indemnifier will be entitled to dispute any such third party claim in the name of the indemnified (but at the cost and expense of the indemnifier);[91]

9.8.3 the indemnified will give the indemnifier all reasonable co-operation and assistance in relation to such dispute;

9.8.4 in relation to any third party claim disputed by the indemnifier in the indemnified's name, the indemnifier will be obliged not to bring the name of the indemnified into disrepute, to keep the indemnified fully informed of the conduct of such claim, and be prohibited from paying or settling such claims without the prior consent of the indemnified;

9.8.5 if the indemnifier does not exercise its right to dispute the claim in the name of the indemnified, then the indemnified should be entitled freely to pay or settle such claim;

9.8.6 the indemnified should be entitled to take over the conduct of any claim against its release of the indemnifier from liability under the indemnity in respect of such claim;[92] and

9.8.7 if the indemnified has received an indemnifying amount from the indemnifier and subsequently recovers a sum from the third party, the indemnified should repay the indemnifier to the extent that the sum

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91 The Institution should be cognisant of the reputational risks of litigation being conducted in its name by a third party, such as the Private Party. The provisions of the third party claims procedure in an Agreement must therefore permit the Institution to take over any litigation. However, typical insurance policies do not permit this as insurers usually seek the right to control any litigation. Specific advice on this issue should be obtained from the insurance broker placing the required insurance for the Project.

92 See footnote 91 above.

recovered (plus the indemnifying amount) exceeds the loss sustained by the indemnified.

9.9 Save where performance or non-performance of the Services may give rise to any type of liability contemplated in Part C:9.2 (*General Obligations: Indemnities*) (that is, death or personal injury, loss of or damage to property, and so forth), the Institution should not rely on indemnities or a general damages claim to provide remedies for poor or non-performance of the Services during the Project Term. The rationale for this is that the payment mechanism in the Agreement should be structured (based on the "no Service, no Unitary Payment" principle) to ensure that the loss to the Institution arising from poor or non-performance of the Services should result in Penalty Deductions and, if so, should be the sole remedy of the Institution during the Project Term. This means that the payment mechanism in the Agreement should operate so as to ensure that, during the Project Term, the Penalty Deductions against Unitary Payments are a genuine reflection of the losses the Institution will incur as a result of the poor or non-performance of the Services.

9.10 However, the Institution should bear in mind that reliance on Penalty Deductions against the Unitary Payments will not compensate an Institution for all losses incurred by it as a result of a breach of the Agreement by the Private Party of its performance obligations.

9.11 This will be the case in relation to the heads of liability referred to in Part C: 9.2. It will also be the case where the breach occurs in the construction phase of the Project, that is, before Service Commencement (when Unitary Payments are not due). For example, because of a delay in the construction of accommodation facilities due to a design fault, the Institution is compelled to make alternative accommodation arrangements (for example, extending its lease). The Institution will need to be compensated for any expenses incurred by it in this regard. To the extent that this compensation is covered by any security or liquidated damages provided against late Service Commencement

(See Part E:21 *(Security against late Service Commencement))*, indemnities will not be appropriate.[93]

Standard Clause

Limitations on Liability

(a) No party entitled to any indemnification under this Agreement shall be entitled to any right to claim damages for breach of Agreement, in delict or on any other basis, to the extent that such damages extend to indirect losses (such as loss of profit, loss of use, loss of production, loss of business, loss of business opportunity or is a claim for consequential losses) suffered or allegedly suffered by the indemnified party.[94] This limitation shall be without prejudice to the Institution's right to claim any Penalty Deduction in accordance with the provisions of this Agreement.

(b) The Institution shall not be liable whether in contract, in delict or otherwise to the Private Party in respect of any negligent act or omission of the Institution relating to or in connection with this Agreement [save for any grossly negligent act or omission]. The Private Party has agreed to this on the basis that it shall mitigate the risks of any such negligent acts or omissions on the part of the Institution by insurance as required in Clause [x].[95]

10 SOLE REMEDY AND MITIGATION

10.1 The indemnities granted by the Institution should be structured on the basis that the Private Party should not be entitled to make any double recovery thereunder (that is, it should not be indemnified for losses for which compensation is provided elsewhere in the Agreement (for instance, pursuant to any Compensation Event)). This principle must also apply in relation to the indemnities granted by the Private Party to the Institution.

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93 The Institution should not need to be able to make claims against the Subcontractors for a Private Party Default. This is because the deductions from the termination compensation payments should reflect any amount that the Institution would require to reinstate the Project to the standard it should have been at but for the default including amounts that it would normally expect to claim from the Subcontractors.

94 Having regard to Part C:9.7, this Standard Clause may need to be amended to exclude third party consequential losses included in the direct losses of the indemnified party.

95 See Part I: *(Insurance)*. See also footnote 90 regarding the inclusion of gross negligence on the part of the Institution in the scope of any Private Party indemnity if permitted under the required insurance.

Standard Clause

Sole Remedy

(a) Save for the Institution's right to claim at any time the amount of the reasonable costs, losses, damages and expenses suffered and incurred by it as a result of rectifying or mitigating the effects of any Private Party Default and any other express right of the Institution under this Agreement, the sole remedy of the Institution in respect of any failure in the delivery of the Services shall be the operation of the Penalty Deductions in accordance with the payment mechanism provided for in this Agreement.[96]

(b) Nothing in section (a) shall prevent or restrict the right of the Institution to seek any interdict or similar relief, any decree of specific performance or any other discretionary remedies of a court.

(c) Notwithstanding any other provision of this Agreement, neither Party shall be entitled to recover any compensation or claim under this Agreement or any Project Document in respect of any loss that it has incurred to the extent that such party is already compensated in respect of such loss.

10.2 Each Party should also be under an obligation to mitigate the consequences of any actions or omissions for which it is entitled to an indemnity under the Agreement.

[96] The Institution must carefully assess this limitation in light of a thorough analysis of any financial risks that may not be covered by the payment mechanism.

These sole remedy provisions do not extend to the Project Deliverables relating to the construction phase of the Agreement on the assumption that these Project Deliverables may be covered by other remedies.

PART D: PROJECT SITE

11 NATURE OF LAND INTERESTS

11.1 Introduction

11.1.1 In the majority of PPP projects that involve the construction of infrastructure, the Institution will make land (often with existing improvements) available to the Private Party. During the Project Term the Private Party will manage the operation and maintenance of such land and infrastructure.

11.1.2 Consideration should always be given to the nature of the interest that the Private Party should have in the land and infrastructure during the Project Term.

11.1.3 The Institution must conduct a thorough due diligence of all property rights in the land and any improvements thereon at the feasibility study phase of the Project to ensure that the Project will not be jeopardised due to a late discovery of a problem relating to the nature of those property rights.

11.1.4 If this due diligence exposes any problems (for example, land claims, rights protected under the Extension of Security of Tenure Act, 1997) that may impede the Institution's ability to grant the Private Party undisturbed possession (save for any rights of access to be retained by the Institution) from the required date of occupation, and these problems cannot be resolved in the feasibility study phase of the Project, then the Institution should not proceed with the procurement phase of the Project.

11.2 Land Transfer or Purchase

11.2.1 As part of the Institution's feasibility study for a proposed Project, the Institution should consider:

11.2.1.1 the extent to which it will be required to make land and improvements available to the Private Party so as to allow the

Private Party to carry out the Project Deliverables;

11.2.1.2 its ability to make such land and improvements available to the Private Party. Here special consideration should be given to any defects in title including those arising from any land claims registered with the Land Claims Commission;[97]

11.2.1.3 the nature of the interest in the land and improvements which the Private Party will acquire pursuant to the Agreement or any ancillary documents;

11.2.1.4 whether any consideration will be payable by the Private Party for such interests or whether such consideration will be provided for through a reduced Unitary Payment; and

11.2.1.5 the extent to which the Institution will require access to or some measure of control over the land and improvements during the Project Term.

11.2.2 If the Project will involve the Institution accessing and using the site (for example, in a hospital project where hospital clinical staff employed by the Institution will require access to the hospital managed and maintained by the Private Party), then the Institution should seek legal advice prior to commencing the procurement process to ensure that the Institution's rights of use are properly protected after the Institution Asset is made available to the Private Party.

11.2.3 In a particular Project the Institution may already own (in the sense of having registered title) the land and improvements. In this case, it can transfer an interest in the land and improvements to the Private Party (for instance by way of a lease), while at the same time securing for itself an interest in the land (by way of a sub-lease) which allows it access to and use of the land and improvements for the Project Term of the Agreement.

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[97] In this regard, a thorough due diligence should be conducted in respect of any title deeds or leases relating to the land and improvements and the land claims register. See Part D:11.3 (*Land Claims*).

11.2.4 If the Institution has a lease interest in the land, then it is likely that the consent of the lessor of land (which could be an individual or a non-governmental entity or, more likely, another organ of state) will be required before the Institution is able to grant any interest in the land to the Private Party. If the nature of the land interest to be granted to the Private Party or to the Institution, as the case may be, is that of lease, and that lease is of a long-term nature (10 years or more), specific consideration should be given on a project-by-project basis as to the benefits of registration of that lease in accordance with the provisions of the Deeds Registries Act, 1937.[98]

11.2.5 In some PPP projects, it may be necessary for a site over which the Institution has no interest to be obtained for the Project. Where the location of a Project Site is critical to the success of the Project, the Institution must obtain appropriate interests in the site at the time of the feasibility study phase of the Project.

11.2.6 Where the location of the Project Site is not critical to the success of the Project, bidders should be encouraged to offer solutions in respect of the land needs of the Project. The Institution should be flexible in its consideration of these solutions.

11.2.7 Where land and property owned by the Institution become surplus as a result of the Project and the Institution wishes to sell the land as an incentive for participation in the tender and thereby obtain a better contract price, the Institution must ensure that it complies with the Treasury Regulations dealing with the disposal and letting of immovable property of the Institution (to the extent that these Treasury Regulations are applicable to that Institution) and any other applicable law.[99] The Institution needs to ensure that the inter-relationship between the

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[98] Specific legal advice in this regard should be obtained. The Private Party's financiers will probably require the registration of the lease since this improves the security of tenure as against third parties.

[99] Treasury Regulation 10.2 requires that the disposal of land and improvements by certain Institutions (whether by way of a sale or lease) must be for market-related value unless otherwise agreed by the relevant Treasury (which is not necessarily the same Treasury for the purposes of Regulation 16). The relevant Institutions subject to these requirements comprise national and provincial departments and constitutional institutions.

realisation of proceeds from the sale of surplus land, and the Facilities from which the Services will be delivered during the Project Term, support the overall objectives of the Project and do not prejudice the Institution's position should an event of early termination arise.

11.3 **Land Claims**

11.3.1 The Restitution of Land Rights Act, 1994 currently affects many areas in South Africa in respect of which land claims have been registered with the Regional Land Claims Commissioner. The cut-off date for the registration of all land claims has passed. Although there is no clear guide for the settlement of such claims, the Act nevertheless does not prohibit development of any land subject to a land claim. The only legal requirement for development to take place is the publication of a notice in terms of section 11(7) of the Act. In terms of that section, notice must be given to the Regional Land Claims Commissioner advising it of the proposed development. Section 11(7)(aA) provides that should the Regional Land Claims Commissioner fail to respond to any such notice within the prescribed period (one month), then no permission is needed from the claimant to proceed with the development in terms of the Act. Provided that one complies with all the other legal requirements for the proposed development there should be no basis for a legal objection to the development. A thorough due diligence of the land claims register for the applicable area should be conducted, and (if there are any) resolved before the application for TA:I.

11.3.2 In order to obtain the protection afforded under section 11 (7 (aA) of the Act for a proposed PPP developments, Institutions must routinely (at the feasibility study phase of their PPP projects) publish their section 11(7) notices. If a response is received indicating the existence of any land claim, the Institution must not proceed to the procurement of the Project until permission has been received for the development to proceed.

11.4 Legal Nature of Land Interests

11.4.1 The legal nature of any land interests that may be granted to a Private Party under an Agreement depends on:

11.4.1.1 the nature of the use rights which the Private Party needs to acquire in order to perform the Project Deliverables; and

11.4.1.2 whether or not the Private Party will be required to pay any consideration for such use rights and, if so, the amount of that consideration.

11.4.2 The terminology used to describe a land-use arrangement (that is, "lease", "concession", "land availability agreement", and so forth) is not decisive as regards the legal nature and treatment of that arrangement.

11.4.3 The essential features of a lease are that:

11.4.3.1 the lessee is granted the right of use and enjoyment of the leased property, with the corresponding obligation to restore that property in its original form as at the commencement of the lease. If the rights conferred under a contract are wider than such use and enjoyment, that is, they entitle the "lessee" to destroy, appropriate or otherwise dispose of the "leased" property thereby diminishing its original substance, then the contract is not a lease;[100] and

11.4.3.2 the lessee must pay monetary consideration (fixed or otherwise clearly ascertainable) for its rights of use and enjoyment. The absence of this obligation indicates a contract of "loan", not a lease.[101]

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[100] For example, a contract pursuant to which the "lessee" has the right to fell and remove non-self-renewing indigenous trees located in an area is not a lease since these rights diminish the substance of the "leased" area.

By contrast, a contract pursuant to which a lessee has the right to fell and remove a crop of self-renewing trees is a lease because the substance of the leased area is not diminished.

[101] The only exception to this requirement for consideration sounding in money is an agricultural lease, where the consideration may be in the form of an ascertainable portion of the crop produced.

11.4.4 Several important legal consequences flow from leases (as opposed to, for instance, concessions), such as:

11.4.4.1 simply stated, the rights of use and enjoyment held by a lessee in occupation of the leased premises are "real" (that is, they are enforceable against third parties, including creditors, of the lessor and subsequent title holders, which means that they survive subsequent changes in ownership of the land) as opposed to "personal" (that is, binding only as against the lessor and not against third parties);

11.4.4.2 long leases (that is, leases with a duration of ten years or more) must also be registered to ensure that these rights remain "real" over the full duration of the lease, failing which these rights (after ten years and even if the lessee remains in occupation) will not generally be enforceable against third parties;

11.4.4.3 if the long lease is in respect of a portion of land, that portion will have to be subdivided. This entails a separation of the portion by way of a diagram that must be approved by the surveyor-general and otherwise meet all conditions for subdivision imposed by the responsible local authority under applicable municipal by-laws);

11.4.4.4 a registered long lease can be specially hypothecated in a deeds registry under a mortgage bond since it is regarded in law as a form of immovable property;

11.4.4.5 the common law security interests of a lessor (that is, a tacit hypothec) in the movables located on the leased premises which become operational when rent is overdue; and

11.4.4.6 the requirement for stamp duties to be paid on leases.

11.4.5 The above legal consequences do not attach to other forms of land-use arrangements such as a concession. There is no generally accepted legal definition of "concession". They are, however, distinguishable from leases in so far as the nature of the rights conferred by them are "personal". Concessions may or may not involve the grant of use rights in respect of land but to the extent that they do, such rights are ancillary to other rights included in the concession. A typical example of a concession is where the concessionaire is granted an exclusive right to carry on a trade (for its own commercial purposes) or operate a service (on behalf of the concessor) in an area, together with an ancillary right to use a piece of land in that area in connection with that trade or operations.

11.4.6 A PPP project may of course involve a combination of land-use arrangements including both a concession and a lease. This will depend on the particular circumstances of the Project in question. The agreement between the Parties regarding the land-use arrangements is typically separate from the Agreement itself and is referred to in this Standardisation as the "Project Site Agreement"

Standard Clause

<u>*Project Site Agreement*</u>

(a) Project Site

(i) The Private Party shall construct the construction Works and deliver the Project Deliverables on the Project Site made available to the Private Party in terms of the Project Site Agreement.

(ii) The Private Party shall throughout the progress of the Works and the conduct of the other Project Deliverables have regard for the safety of all persons at the Project Site (whether lawfully or not) and shall keep the Project Site, the Works and the Facilities in an orderly state as appropriate in accordance with Good Industry Practice to avoid danger to such persons.

(iii) With effect from the Expiry Date, the Private Party's unencumbered interest in the Project Site Agreement shall automatically be assigned to the Institution, without the need for any further formality to give effect to such assignment. The Private Party shall not be entitled to any compensation in respect of such assignment. Notwithstanding the aforesaid, the Private Party shall, on demand of the Institution, duly execute all documents including any variation to the terms of the Project Site Agreement, which may be required by the Institution in connection with such assignment.

(b) Compliance with Title Deeds

The Private Party shall procure that:

(i) all Project Deliverables carried out at the Project Site by or on behalf of the Private Party whether before, during or after the completion of the Works shall be carried out in a manner that does not breach any conditions of the title deeds of the Project Site; and

(ii) there shall be no conduct which gives rise to a right on the part of any person to obtain title to the Project Site or any part of it save in accordance with the terms of this Agreement and the Project Site Agreement.[102]

11.5 Tax Considerations

11.5.1 The nature of the land interest to be granted to a Private Party may impact on any tax benefits that the Private Party may seek in connection with the expenditure incurred by it in relation to improvements to the land.

11.5.2 It is essential that the taxation consequences of the choice of land interest be thoroughly considered and that specialist tax advice in this regard be obtained. This is because any negative taxation consequences (for example, the Private Party's inability to claim allowances) flowing from an Institution's preferred land-use arrangement will influence the bid price and ultimately the value for money afforded by a project.

11.5.3 Notwithstanding that the Institution may for various reasons have a preferred position regarding the appropriate land arrangements for a particular project, the Institution should request comment from the bidders early on in the procurement phase regarding the taxation consequences of a preferred position.

[102] The form of agreement dealing with the Parties' land interests attached to the Agreement and/or the Agreement itself should deal with the Private Party's access rights on a non-exclusive basis where the Institution requires access and use rights in respect of the Project Site (as in the case of a hospital or accommodation project). Where in any particular PPP project, the Institution does not require access to or use of the Project Site for the conduct of any of its own functions, and the Private Party requires exclusive possession of the whole or any part of the Project Site, the Institution should be cognisant of the possibility that it may need to regain possession of the Project Site, for example, on early termination of the Agreement.

12 CONDITION OF PROJECT SITE

12.1 Introduction

12.1.1 The Institution must require bidders to conduct a thorough investigation of the proposed Project Site whether the Project Site is a greenfield or a brownfield site. This investigation should be done during the bid phase of the Project.

12.1.2 If the Project Site is a brownfield site with existing infrastructure that is to be made available to the Private Party for the performance of the Project Deliverables, the Institution should be cognisant of any practical limitations that may affect the Private Party's ability properly to investigate the Project Site and, as such, these limitations should be accommodated.

12.1.3 It is critical that in any proposed PPP where the location of the Project Site is critical for the success of a Project and bidders are not given a choice regarding the selection of the Project Site, for the Institution to appoint experts to undertake surveys (at the feasibility study phase of the Project) to consider geotechnical and environmental conditions and archaeological, palaeontological or other heritage conditions at the proposed location. Such surveys should, for instance, at least include a review of any public registers maintained in terms of applicable heritage legislation to establish whether the location (or any part of it) is protected under such legislation. The costs of such surveys must be included in the affordability analysis required for TA:1.

12.1.4 The purpose of these surveys is to uncover any problems that are likely to cause regulatory delays in the implementation of the Project or otherwise impact on its affordability and value for money.

12.1.5 Should such problems be uncovered at the proposed Project Site and yet the Institution nevertheless wishes to proceed with the location of the PPP Works at such Project Site, the Institution will be required to implement measures (including obtaining any necessary consents from any Responsible Authorities having jurisdiction, or concluding inter-governmental agreements with affected Responsible Authorities to fast-track the resolution of any consent applications) satisfactory to the relevant Treasury before proceeding with the procurement phase of the Project.

12.2 **Latent Defects**[103]

12.2.1 In a greenfield project (that is, one involving virgin land and new facilities) where the Private Party will bear the design and construction risk for the Facilities to be constructed by it, the latent defect risk (that is, the possibility of loss or damage arising from latent defects in the Project Site as well as the Facilities to be constructed on the Project Site) should also be borne by the Private Party.

12.2.2 In a brownfield Project (that is, one involving a developed Project Site) particularly where existing Institution Assets on the Project Site are to be made available to the Private Party and there is no or insufficient insurance available to cover latent defects in such Project Site and/or Institution Assets, the Institution would generally be expected to assume the latent defect risks.

12.2.3 The Institution should, however, not readily assume the latent defects risk in a brownfield project. Instead, whether or not this risk should be assumed by the Institution should be determined on a project-by-project basis having regard to the particular circumstances of each Project, including, without limitation, the length of time over which existing facilities on the Project Site have been operational, and should, in any event, always depend on value for money considerations. Thus, for example, an Institution should not readily assume latent defects risk in respect of the structure of existing facilities that have been operational for a lengthy period without an indication of a structural defect. On the other hand, where the facilities have not been operational for any substantial

[103] See Part C:8 (*Warranties and Representations*).

period of time and, accordingly, have not really been "tested", the Institution should expect to assume some of this risk (unless any construction guarantees are still in effect and can be transferred to the Private Party). Risk sharing between the Parties may be appropriate having regard to the nature of the assets and may not be the same across the entire Project Site. In other words, certain parts of the Project Site may be perceived differently by the Parties as having lesser risk of latent defects.

12.2.4 Further, if an Institution does assume any latent defect risk, it should ensure that the Private Party is under a clear obligation to mitigate the potential effects of this risk. The Institution should implement (if practicable) the following mitigation measures:

12.2.4.1 bidders should be given a reasonable opportunity to conduct a thorough investigation of the Project Site in order to expose any latent defects and the extent of any required remediation;

12.2.4.2 prior agreement should be reached between the Parties on the scope of the remedial works that will be required to be undertaken to fix identified defects to the satisfaction of the Private Party;[104]

12.2.4.3 the cost of the remedial works for identified defects should be pre-agreed. Any such costs paid for by the Institution must be certified by the Private Party as being sufficient to remove these defects to the satisfaction of the Private Party;

12.2.4.4 the liability of the Institution in relation to latent defects should not be capped if this is necessary to achieve affordable bid prices (as bidders will usually price for the cap through higher bid prices) and value for money for the Institution. It should not, however, be readily assumed that no cap will necessarily ensure value for

[104] Here the Institution should not be tempted to be overly prescriptive regarding the scope and nature of the remedial works as the risk of implementing such works should be shifted to the Private Party in the Agreement. The Institution's main concern should be to ensure that such works align with, and do not exceed (in terms of scope and costs), what really needs to be done (having regard to applicable law).

money. Further, the Institution's liability should not be triggered in respect of minor defects discovered after the Signature Date. In other words, the Institution should consider whether value for money requires that its liability be subject to a "floor" (in addition to any cap, or no cap); and

12.2.4.5 the Private Party should be under an ongoing obligation to report on the condition of the Project Site and the discovery of defects.

12.2.5 The Institution should consider the usefulness of appointing an Independent Expert to oversee the investigation referred to in Section 12.2.4.1 above in order to ensure that the investigation is reasonably thorough. This is because the Private Party will be dis-incentivised by the limitations in Section 12.2.4 from discovering the latent defects. Furthermore, the Independent Expert should be mandated to oversee the implementation of the remedial works agreed to between the Parties.

13 LAND USE AND PLANNING CONSENTS

13.1 The recommended approach in respect of PPP projects involving construction Works is that planning risks (that is, the possibility that the proposed use of the Project Site in terms of the PPP agreement and, in particular, the construction of the Facilities on the Project Site, will fail to comply with any applicable town-planning scheme (including land zonation), any required planning permission and any applicable building standards or required Consents, or that a detailed planning Consent cannot be obtained or, if obtained, can only be implemented at a greater cost than originally projected) should be shared between the Parties as follows:

13.1.1 where the selection and acquisition of all appropriate land interests in the Project Site is the responsibility of the Institution, the Institution should be responsible for obtaining any re-zoning and land-use Consents required for the Project Site.[105] This should be done at the time of the feasibility study phase of the Project and not after the Project has been put out to tender. The costs of these Consents should be included in the affordability assessment forming part of the application for TA:I; and

13.1.2 all planning risks associated with the detailed design and building of the facilities included in the Works should be borne by the Private Party, which should adequately provide in its Works programme for the time period which may be required to obtain such Consents.[106]

Standard Clause

Private Party Consents

The Private Party shall be responsible for:

(a) obtaining all Consents (other than those listed in Schedule [x]) which may be required for the performance of the Project Deliverables;[107] *and*

(b) implementing all Consents in accordance with their respective terms within the period of its validity.

13.2 The Private Party's failure to obtain Consents which it is required to obtain by the applicable milestone dates in its Works programme must not be dealt with as a Relief Event or Compensation Event.

14 ENVIRONMENTAL CONSENTS

14.1 The same considerations relating to latent defects (see Part D:12.2 *(Latent Defects)*) generally apply here.

14.2 The responsibility for conducting any macro-level environmental impact investigation into, assessment of and reporting on (to the Responsible Authorities) the proposed activities to be incorporated in the proposed Project Deliverables as required pursuant to section 24(7) of the National

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[105] The Institution should ensure that the proposed development is in line with the macro-planning policies of any Responsible Authorities having planning jurisdiction over any portion of the proposed Project Site, such as the Integrated Development Plans of any municipalities having jurisdiction.

[106] It is common practice in the construction industry for building contractors to incorporate contingencies into their construction contracts to provide for delays in obtaining any necessary planning Consents.

[107] The Schedule should list those Consents that have or will be obtained by the Institution.

Environmental Management Act, 1998 ("**NEMA**"), should be borne by the Institution. The costs associated with conducting this NEMA assessment should be for the Institution and should be incorporated in its feasibility study and reflected in the affordability assessment included therein, submitted as part of its application for TA:I.[108]

14.3 The intention here is that the Institution should not put the Project out to tender until the investigations required under NEMA (if applicable) into the potential impact of the proposed activities on the environment have been completed and reported to and considered by the Responsible Authorities. Further, that any concerns raised by the Responsible Authorities in response to such report should be dealt with by the Institution in advance of the tender to reduce the scope for any delays in the tender process (and implementation of the Project after the award of the tender) arising from the potential environmental impact of the Project.

14.4 On the other hand, the responsibility for conducting any scoping and environmental impact assessment ("**EIA**") required pursuant to the Environment Conservation Act, 1989 (the "**ECA**") of the proposed activities should be borne by the Private Party since this is dependent on the specific design and construction parameters of the Works (that is, dependent on inputs) which is the responsibility of the Private Party. The Private Party must assume all risks associated with any such EIA and should adequately provide in its Works programme for the time it will require to conduct the EIA and obtain a record of decision in relation to the EIA. The EIA should not be a suspensive condition of the Agreement. However, a delay in obtaining a record of decision from the Responsible Authority approving the EIA by the applicable milestone date in the Works programme should be a Relief Event, but only if this arises because of circumstances beyond the Private Party's control. Such

[108] The construction of a new road through a forest, a new airport and a new prison in areas where there are no similar developments are examples of developments where a macro-level investigation (sometimes referred to as a "**Strategic Environmental Assessment**" or "**SEA**") has to be undertaken to ascertain the cumulative environmental impacts of the proposed development for the general area in which the proposed development will be located. By comparison to an EIA, the SEA is not directed to the specific design parameters of the proposed development and the immediate impact thereof on the environment at the specific location of the proposed development. However, an SEA can contribute significantly to the early and successful implementation of a Project by reducing the time and effort entailed by an EIA. For instance, if an SEA determines that the proposed route of a new road will have a cumulative detrimental impact on the environment and this determination is made before the Project is put out to tender, the Institution will avoid the wasted time and costs that will arise if the SEA is not undertaken but a similar determination is made pursuant to the EIA undertaken by the Private Party.

a delay should not be a Compensation Event even if it arises because of circumstances beyond the control of the Private Party.

14.5 The Private Party should also bear all environmental risks associated with the performance of the Project Deliverables, and should be liable for any risk of loss or damage to the Project Site or third party property arising in connection with such performance.

14.6 If, however, the Project Site is a brownfield site with pre-existing environmental contamination (whether caused by the Institution or any other prior user of the Project Site), then the Institution may be expected to assume (as between it and the Private Party) the environmental risks associated with the prior use of that Project Site. Depending on the extent of the pre-existing contamination of or at the Project Site, the Private Party may not agree to share in the risks associated with such pre-existing environmental contamination, particularly in relation to any third party claims in respect of such contamination because the Private Party's potential exposure (unless capped) would be difficult to quantify and potentially open-ended. The Institution should not, however, always assume that the Private Party's potential exposure will be difficult to quantify and should seek specific advice from its own adviser regarding any quantification or non-quantification proposed by the Private Party. If the Project involves the assumption by the Private Party of existing operations which have caused or contributed to such contamination, the Private Party will also be exposed to the risk that such activity may be compulsorily ceased or adversely restricted by the Responsible Authority in order to stop the continuation of such contamination. The Private Party will in these circumstances seek to be indemnified against any losses it may incur as a result of any such cessation or adverse restriction.

14.7 Any indemnity so granted by the Institution should be subject to limitations discussed in Part C:9 (*Indemnities*) and Part C:10 (*Limits on Liability and Mitigation)*.

14.8 In this regard, the Institution should obtain specific advice from the insurance broker appointed to place the insurance required for the Project regarding the availability of any insurance that will cover pre-existing environmental contamination.[109]

14.9 If such insurance is not available or, if available, too expensive to maintain, and the circumstances of the Project justify the grant of indemnities by the Institution in relation to the risk of loss resulting from pre-existing environmental contamination, then the Institution should ensure that (in addition to the limitations discussed in Part C:9 (*Indemnities*) and Part C:10 (*Sole Remedy and Mitigation*)) mitigation measures are put in place to limit the Institution's potential exposure. Such mitigation should include the carrying out of a thorough investigation by an Independent Expert to establish the extent of any pre-existing environmental contamination and the scope and nature of any remedial works.

14.10 As a further mitigation measure, the Institution should ensure that the Private Party has obtained "sign-off" from any Responsible Authority regarding the scope and nature of the remediation works. However, the Institution should also satisfy itself that these remedial works (even if such sign-off is obtained) do not exceed the minimum standards imposed under applicable environmental law if the cost implications of so exceeding the minimum standards will impact negatively on the desired affordability and value for money levels for the Project. For example, if the minimum remedial standard for any environmental contamination is containment as opposed to the removal of the contamination, the Institution should agree that where the Private Party elects to exceed the minimum standard and remove the contamination, the cost differential in the two remediation measures should be borne by the Private Party.

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[109] For instance, pre-existing environmental contamination can be covered by legal liability insurance policies that are issued on a "claims made" basis which allows recovery for "historical" conditions that arose prior to the Signature Date (as opposed to a "losses occurring" basis). If the legal liability insurance policy is issued on a "losses occurring basis", that policy will not cover historical conditions. It should not be assumed that there will always be a significant price differential between "claims made" and "losses occurring" legal liability insurance.

Specific insurance advice must, therefore, be obtained by an Institution if there are any risks of pre-existing environmental contamination or any latent defect risk in brownfield PPP projects. Whether such insurance should be required for such a PPP project will depend on whether the cost of such insurance (and of not having such insurance) will impact negatively on value for money.

14.11 The Institution should not be prescriptive regarding the scope and nature of the environmental remediation works, save to the extent that the cost of any such works exceeds the costs of the minimum standards imposed by applicable law. Here, the Private Party would be entitled to undertake whatever environmental remedial works it deems appropriate subject to any required minimum standard, but will bear the costs of exceeding such required minimum standard.

14.12 The Institution should bear in mind that the capping of the risk exposure for pre-existing environmental contamination identified for remediation (or, for that matter, environmental contamination that is not identified in the course of the investigation referred to above) will be difficult to negotiate with the Private Party and its funders given that minimum remedial standards applicable at the time when the remedial works are agreed may change. The Private Party (and particularly, its funders) will not be willing to assume the risk of changes in environmental standards which may expose them to liability in respect of pre-existing environmental contamination.

14.13 The appointment of an Independent Expert to oversee the investigation of the Project Site for pre-existing environmental contamination and to advise the Parties regarding the minimum remedial standards that need to be met is essential.[110] It may also be appropriate for the Institution to set aside a pre-agreed sum of money to pay for agreed environmental remedial works in order to avoid delays in the reimbursement of costs incurred by the Private Party in undertaking such works that may arise as result of the Institution's budgetary processes.[111] The management of those funds could, with the prior approval of the relevant Treasury, be done jointly between the Parties with the Independent Expert acting to certify invoices for completed environmental remediation works presented for payment by the Private Party.

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[110] See Part S:87.11 (*Miscellaneous: Dispute Resolution*) regarding the appointment of Independent Experts.

[111] This is particularly appropriate where the undertaking of the works is urgent and where delays will exacerbate the costs to the Institution.

14.14 It is important that the Institution not permit the issue of pre-existing environmental contamination to cloud the issue of the Private Party's responsibility for environmental risks arising from those Project Deliverables that are not affected by the pre-existing environmental contamination. Further, where the Private Party is obliged to undertake any environmental remediation works, the Institution should carefully assess whether any such works are more properly dealt with as part of the ordinary operation and maintenance obligations of the Private Party. In other words, the Institution should carefully consider whether ordinary operational risks associated with the ongoing operational obligations of the Private Party are incorrectly treated as environmental risks associated with pre-existing environmental contamination. The Institution should be particularly concerned that any funds set aside to finance the cost of agreed environmental remediation works is not utilised to fund the ordinary operation and maintenance obligations of the Private Party.

Standard Clause[112]

Project Site Conditions

(a) *The climatic, hydrological, hydrogeological, ecological, environmental, geotechnical, geological, palaeontological heritage and archaeological conditions of the Project Site (the "**Project Site Conditions**") shall be the sole responsibility of the Private Party. Accordingly, without limiting any other obligations of the Private Party that are included in the Project Deliverables, the Private Party shall be deemed as of the Signature Date to have:*

(i) *carried out an investigation of all Project Site Conditions and of any extraneous material in or under the Project Site including its surface, sub-soil and ground water to enable the Facilities to be designed and constructed and the Works to be carried out with due regard for the Project Site Conditions and the seismic activity (if any) in the region of the Project Site;*

(ii) *for the purpose of such investigation in section (i), inspected and examined the Project Site and surroundings;*

(iii) *satisfied itself as to the nature of the Project Site Conditions, the surface, sub-soil and ground water of the Project Site, the form and nature of the Project Site, the load-bearing and other relevant properties of the Project Site, the risk of damage to property affecting the Project Site, the nature of the materials*

112 These Standard Clauses assume that the Project Site is a greenfield site and that the Private Party has been given the opportunity to make any necessary investigations. If the Project Site is a brownfield site, then the Standard Clause will not be appropriate.

(whether natural or otherwise) to be excavated and the nature of the design, works and material necessary for the execution of the Works;

(iv) satisfied itself as to the adequacy of its right of passage over, access to and through the Project Site and any accommodation it may require for the purposes of fulfilling any of its obligations included in the Project Deliverables, such as any additional land or buildings located outside the Project Site;

(v) satisfied itself as to the possibility of interference (whether lawful or unlawful) by persons of any description whatsoever, other than the Institution, with access to or use of the Project Site with particular regard to the owners and users of any land adjacent to the Project Site; and

(vi) satisfied itself as to the precautions, times and methods of working necessary to prevent or minimise nuisance or interference being caused to any third parties.

(b) To avoid doubt, the Private Party accepts full responsibility for all matters in section (a) and the Private Party shall:

(i) not be entitled to make any claim against the Institution whether in contract, delict or otherwise, (save, if applicable, as expressly provided in Clause [x][113]) on any ground including the fact that incorrect or insufficient information on any matter relating to the Project Site was given to it by any person including the Institution;[114] and

(ii) be responsible for and indemnify the Institution against all direct losses sustained by the Institution in consequence of cleaning-up and otherwise dealing with any potentially hazardous materials (being any natural or artificial substance, whether in solid, gaseous or liquid form capable of causing harm to any human or any other living organism supported by the environment (including air, water, land, surface land and sub-surface land) or capable of damaging the environment or public health or posing a threat to public safety including any pollutants and any hazardous, toxic, radioactive, noxious, corrosive or dangerous substances and all substances for which in each case liability or responsibility is imposed under applicable environment law) at the Project Site.

Compliance with Environmental Law and Consents

(a) The Private Party shall use all reasonable endeavours to procure and maintain in full force and effect all necessary environmental Consents required in respect of the Project Deliverables.

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113 This refers to the provisions dealing with Relief Events, Compensation Events or *Force Majeure*, in Part J:.

114 In a Project involving a brownfield site, information warranties may have to be given if the Private Party cannot independently verify the Institution's information. In such a Project, the limitation in this Standard Clause relating to the Institution's information will have to be qualified accordingly.

(b) *The Private Party shall comply with all applicable environmental laws and all such environmental Consents.*

(c) *The Institution shall provide the Private Party with all such assistance as may be reasonably necessary for the Private Party to obtain all necessary environmental Consents; provided, however, that the Institution shall incur no liability for the costs of or any failure or inability of the Private Party to obtain any such environmental Consents.*

15 HERITAGE RESOURCES[115]

15.1 The Private Party must comply with all applicable legislation relating to heritage resources (including all buildings and structures that are older than (60) sixty years and archaeological and palaeontological resources) in the conduct of the Project Deliverables. Pursuant to such legislation, a heritage impact assessment will have to be conducted prior to the commencement of any construction or development. Provision is also made in such legislation for the heritage impact assessment to be conducted as part of the EIA required for such construction or development. That legislation also governs the issue of ownership of all heritage resources discovered in the course of conducting any works on land.

15.2 At the bid phase of a Project, bidders must be given an opportunity to conduct a survey to establish the age of all buildings and structures at the Project Site. The discovery after the Signature Date that any building or structure at the Project Site is a protected heritage resource and any resultant delays in the Works required for the Project must be neither a Relief Event nor a Compensation Event.

15.3 Bidders should also be given the opportunity to conduct geotechnical surveys to establish the condition of the Project Site not only for environmental weaknesses but also for any palaeontological, archaeological and other heritage resources (such as burial grounds of cultural significance). The discovery after the Signature Date of any heritage resource that could have been discovered through the exercise of reasonable due diligence on the part of

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[115] This term refers to all heritage resources as contemplated in the National Heritage Resources Act, 1999 (the successor to the National Monuments Act, 1969), and any corresponding provincial legislation.

the Private Party should not be a Relief Event or a Compensation Event. The discovery after the Signature Date of any heritage resource that could not be discovered through the exercise of reasonable due diligence by the Private Party should be treated as a Relief Event entitling the Private Party to an extension of time, but the financial risks associated with such discovery must be borne by the Private Party (that is, not a Compensation Event) unless otherwise agreed at the time of discovery. In this regard, see Section J:43 *(Relief Events)*.

15.4 If the discovery of any heritage resource entitles the Private Party to any relief as aforesaid and the Private Party is instructed to undertake any additional works or variation in the Works in connection with such discovery, then the Private Party will be entitled to compensation for such works (which shall be deemed to be an Institution variation) in terms of the provisions dealing with Institution Variations. If not, then the works shall be deemed to be a Private Party Variation.

15.5 If any heritage resources are discovered in the course of such due diligence, the Institution should endeavour to obtain any necessary Consents for the proposed PPP development from the Responsible Authority before the Signature Date and should assess the cost implications for the Project of any actions required by such Responsible Authority in relation to such discovery.

Standard Clause

<u>Heritage Objects and Resources</u>

(a) Discovery

Upon the discovery of any heritage object or resource (as defined in the National Heritage Resources Act, 1999 or any corresponding provincial legislation) during the course of the Works, the Private Party shall:

(i) promptly notify the Institution of such discovery;

(ii) take all necessary steps not to disturb the heritage object or resource, including cease any Works to the extent that the carrying out of such Works might reasonably endanger the heritage object or resource or prevent or impede its excavation; and

(iii) take all necessary steps to preserve the heritage object or resource in the same position and condition in which it was discovered.

(b) Action

(i) The Institution shall promptly and in any event within [x] Business Days of the notice in section (a)(i) issue an instruction to the Private Party specifying what action the Institution requires the Private Party to take in relation to such discovery.

(ii) The Private Party shall promptly and diligently comply with any instruction so issued (save to the extent that such instruction constitutes a proposal by the Institution for a deemed Institution Variation as provided in Clause (iv) below, in which case the variation procedure provided for in that Clause [x] shall apply)[116] *at its own cost.*

(iii) If so directed by the Institution or Responsible Authority, the Private Party shall allow representatives of the Institution or Responsible Authority to enter onto the Project Site for the purposes of removal or disposal of such discovery; provided that such entry shall be subject to the Institution or Responsible Authority complying with all relevant safety procedures which shall include any relevant health and safety plans for the construction of the Facilities and any reasonable directions regarding the safety of the Project Site that may be issued by or on behalf of the Private Party.

(iv) If the discovery is a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities) which are not Works that would be necessary for the purpose of compliance with applicable law or any Consents, then such works shall be deemed to be an Institution Variation and the provisions of Clause [x] (Institution Variation) shall apply.

(v) If the discovery is not a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities), then such works shall be deemed to be a Private Party Variation and the provisions of Clause [x] (Private Party Variation) shall apply.

16 UTILITIES AND RESOURCES

16.1 The utilities supply risk (that is, the possibility that any utility such as water, electricity or reticulated gas that will be required for any part of the Project Deliverables (not limited to the construction Works) may not be available)

[116] In this regard, see Part K: *(Changes in Law and Variations)*.

should be borne by the Private Party unless the supply of any such utilities falls within the functional competence of the Institution.

16.2 However, where the location of the Project Site is a critical requirement of the Institution (such as the location of a prison) and any required utilities are not available in the vicinity of the Project Site, the Parties may share some of the risks associated with utilities supply. This risk sharing may involve the provision by the Institution (at its cost) of all required connections for the supply of utilities up to the boundary of the relevant Project Site and the provision of all connections to the Facilities from the boundary of the Project Site by the Private Party (at its cost). The sharing of the risk in these circumstances should be assessed on a project-by-project basis.

16.3 However, the Institution should generally not, in the circumstances contemplated in Section 16.2, assume any ongoing responsibility for the supply of the utilities up to the boundary of the Project Site after the required connections become operational. Thus, interruptions in the supply of utilities after the required connections become operational should be at the Private Party's risk and should not be treated as Compensation Events. This means that the risk of not only on-site, but also off-site, failures in the supply of utilities is for the Private Party. If, however, value for money considerations require the Institution to bear some of the risk of off-site failures in the utilities supply, this risk should only be borne by the Institution to the extent of an interruption in the performance of the Project Deliverables.

16.4 In this regard, the Institution should bear in mind that losses of profit associated with this risk are insurable in terms of business interruption insurance, which the Private Party will probably maintain (usually, at the insistence of its funders). The Institution should obtain specific advice on this issue from the insurance broker appointed to place the insurance required for the Project.

16.5 The Institution should bear in mind that to the extent that it assumes any part of the risk associated with providing any required connections for the supply of utilities up to the Project Site, a delay in the provision of these connections may impact on the Works programme of the Private Party and ultimately the Service Commencement Date. Here, the Institution should consider the possibility of dealing with any such delay as a Relief Event entitling the Private Party to an extension of time or even as a Compensation Event entitling the Private Party to compensation. However such delay should not be treated as a Compensation Event if delay in start-up insurance is available to cover this risk.[117]

16.6 The input or resource risk (that is, the possibility of a failure in the supply of inputs or resources (for instance, coal and other fuels) required for any Project Deliverables, including any deficiencies in the quantities and quality of such inputs or resources) should also be borne by the Private Party, unless the Institution is the supplier of such inputs or resources.

16.7 Where this risk is borne by the Private Party, the Private Party will probably enter into "requirements contracts" (often on a "take-and-pay" basis)[118] with suppliers pursuant to which the suppliers (in turn) will assume the risk of any failure in the supply by agreeing to meet the full supply requirements of the Private Party from time to time and to indemnify the Private Party against losses sustained by it if these requirements are not supplied. These contracts should be included in the Project Documents and be reviewed by the Institution in light of the considerations mentioned in Part B *(Project Documents and Operations)*.

[117] Part J: (*Relief Events*).

[118] Meaning that the Private Party's obligation to pay for any inputs supplied is conditional upon delivery of the required inputs.

PART E: DURATION AND SERVICE COMMENCEMENT

17 DURATION

17.1 The Agreement must specify its duration. A distinction may need to be made between the period (if any) from the Signature Date to the commencement of the Service Period, and the Service Period itself. It may also be appropriate to specify a "Long Stop Date" for the commencement of the Services, non-fulfilment of which may amount to a breach of the Agreement entitling the Institution to terminate the Agreement.[119]

17.2 The choice of duration should be considered in light of the following factors:

17.2.1 the requirements of the Institution in relation to the Services;

17.2.2 the possibility of alternative uses of the Project Assets;

17.2.3 the affordability of the Services for the Institution in light of its anticipated future budgetary allocations and also the expected useful economic life of the Project Assets. Here, the basic principle is that a longer duration Agreement may be more affordable as this may reduce the amount of the Unitary Payments over the Project Term;

17.2.4 the need for any major refurbishment on replacement programmes in respect of the Project Assets over the Project Term; and

17.2.5 the term of the Debt (a longer debt service period could allow longer duration).

17.3 One factor influencing a shorter Project Term is where the Project Assets have an alternative use so that the Private Party would be able to recover a portion of the cost of financing its investment in the Project by putting such Project Assets to an alternative use or selling them after the Expiry Date. Here the Unitary Payments should be lower and the Project Term should be shorter than would be the case if the

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[119] As the ultimate goal of the Institution is Service Commencement and not termination it is important that the need for a Long Stop Date be carefully considered particularly in relation to value for money. This issue should be considered at the feasibility study phase. In this regard see the Feasibility Study Guidance.

It may instead be appropriate to provide inducements for the commencement of the Services by a scheduled date by way of incentives. This should, however, also be assessed having regard to value for money considerations.

Project Assets had no alternative use. This assumes, however, that the Institution will not require the Project Assets after the Expiry Date in order to provide (either itself or through a third party) services similar to the Services. If the Institution requires the Project Assets, their alternative uses will not be a relevant consideration.

17.4 If there is a substantial risk of technical obsolescence[120] resulting from rapid technological changes or changes in the functional requirements of the Institution, with the result that the Services may become redundant before the Expiry Date, then the Institution may wish to negotiate for some flexibility for a shorter Project Term. The implications of such flexibility for the affordability of the PPP project and its anticipated value for money will have to be assessed on a project-by-project basis.

17.5 A number of events, particularly Relief Events, will have a significant impact on the Service Commencement Date as well as the timing of the Service Commencement Date. See Part J:46 *(Relief Events)*. Relief Events should not lead to an extension of the Project Term.

Standard Clause

Duration of Agreement

(a) This Agreement and the rights and obligations of the Parties under this Agreement shall take effect on the Signature Date.

(b) The Service Period shall commence on the Service Commencement Date and terminate on the earlier of the Expiry Date and Termination Date.

18 DESIGN RISK AND SERVICE COMMENCEMENT

18.1 Introduction

18.1.1 It is assumed in this Standardisation that the Agreement will provide for a construction or development phase from the Signature Date to the Service Commencement Date, during which period the Private Party will carry out its construction or development obligations included in the Project Deliverables.

18.1.2 The Institution should satisfy itself during the conduct of the evaluation of the Private Party's bid and the negotiations on the Agreement (and in any event

120 Part F:31 *(Planned Maintenance)*.

prior to the Signature Date), that the Private Party's design proposals[121] included in its bid will achieve the required output specifications as set forth in the RFP. Furthermore, the Institution should ensure that the Private Party's design proposals as set forth in its bid is incorporated into the Agreement, although the Agreement should be sufficiently flexible to accommodate design changes and improvements (at the risk of the Private Party). To the extent that any such changes or improvements result in a change to the scope of the Services or the output specifications, this will constitute a Private Party Variation and must be dealt with accordingly.[122] During this phase, the Institution will want the re-assurance that the construction or development will be capable of delivering the Services on time and in a way that meets the Institution's output specifications in the Agreement. Conversely, the Private Party will not want to be "micro-managed", although it may want some reassurance from the Institution that what it is constructing or developing will meet the required output specifications. This re-assurance and objectivity is provided to both the Institution and the Private Party by the Independent Certifier who will inspect the completed Works and if satisfied will issue the Completion Certificate. While the Institution should be entitled to monitor the Works during the construction or development phase it should not have any approval rights in respect of Works. The ultimate risk and responsibility for the Works is with the Private Party who, once the Independent Certifier has issued the Completion Certificate, will issue the Availability Certificate certifying Service Commencement.

18.1.3 The prescribed approach of the National Treasury in relation to design risks (that is, the possibility that the design of the Facilities to be constructed or developed may not achieve the required output specifications) is that such risks should be borne by the Private Party. Accordingly, the key issue is the extent to which the Institution should be involved during the construction or development phase and what rights, if any, it should have to monitor and review the Private Party's progress.

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[121] This is usually the preliminary design. The detailed design is almost always finalised after Signature Date and is subject to the review of the Institution.

[122] See Part K:50 (*Variations)*.

18.1.4 After the Signature Date, but prior to the Service Commencement Date, the role of the Institution should include:

18.1.4.1 reviewing and commenting upon changes and further developments in the Private Party's design and detailed design. The costs of changes to the design should be borne by the Private Party. The Agreement should clearly stipulate that such review by the Institution will not excuse the Private Party from any liability in respect of the design;

18.1.4.2 reviewing and observing tests of any equipment being developed;

18.1.4.3 reviewing the Private Party's activities in accordance with the quality management system of the Private Party, which must be pre-agreed and incorporated into the Agreement.

18.1.5 The Institution's role, therefore, is confined to the Institution reassuring itself that the delivery programme is on track and that any overriding safety issues will be satisfactorily addressed. The Agreement provisions dealing with the Institution's access to information and to the Project Site during the construction or development phase should be drafted to provide for the limited scope required by the Institution, unless the Institution requires greater access to fulfil a statutory duty or comply with a statutory function.

19 INDEPENDENT CERTIFIER

19.1 Introduction

The Independent Certifier is an expert[123] who will be responsible for overseeing the Works and, if satisfied that the Works have been satisfactorily completed, for issuing the Completion Certificate. Once the Completion Certificate has been issued the Private Party may issue the Availability Certificate signalling Service Commencement. The Agreement must, however, clearly stipulate any necessary liaison procedures between the Institution and the Private Party in order to ensure

[123] Depending on the nature of the Project, the identity of the expert will vary. In construction contracts this will be a person with construction experience.

that the Institution is aware of the imminent Service Commencement and is in a position to accept Service Commencement on the Service Commencement Date.

19.2 **Appointment**

The Independent Certifier should be jointly appointed by the Parties. The Independent Certifier should have a duty of care to both the Private Party and the Institution. The Private Party should, however, be responsible for payment of the Independent Certifier's fees. The Agreement should clearly stipulate that the fact that the Independent Certifier is paid by the Private Party does not in any way derogate from its fiduciary duty to the Institution.

19.3 **Duties**

19.3.1 The primary function of the Independent Certifier is to oversee the Works, attend any performance testing during commissioning, inspect the Works, advise the Private Party of any items that in the Independent Certifier's opinion require rectification and, finally, when satisfied, to issue the Completion Certificate.

19.3.2 It is essential that the terms of reference for the appointment of the Independent Certifier be agreed between the Parties and the Independent Certifier. It is advisable for this to be included in a separate agreement which should clearly stipulate the role of the Independent Certifier.

19.4 **Risk**

The Independent Certifier is appointed to provide a reasonable and objective measure of ensuring that the Private Party conducts the Works satisfactorily. In performing its functions, the Independent Certifier does not in any way acquire any risk in relation to the design, development or construction of the Works. The Agreement must clearly stipulate that the risk remains with the Private Party.

20 ACCEPTANCE AND SERVICE COMMENCEMENT

20.1 New Services

20.1.1 Before Service Commencement, the Private Party should be obliged to demonstrate that the Facilities will meet the required output specifications. The method of demonstration to be used by the Private Party will be project-specific but may take the form of inspections, demonstrations, acceptance or commissioning trials or other performance tests.

20.1.2 The Agreement should set out in detail:

20.1.2.1 the nature of, and timetable for, such performance tests to be conducted by the Private Party;

20.1.2.2 the provision by the Private Party to the Independent Certifier and the Institution of adequate prior notice of any performance test, particularly if the Institution has to set aside resources and staff to participate in such performance tests;

20.1.2.3 the rights of the Institution and the Independent Certifier to access the Project Site to witness the performance tests where the Institution does not otherwise have access to the Project Site;

20.1.2.4 the documents required to evidence the results of the performance tests;

20.1.2.5 that the Independent Certifier shall be responsible for assessing the success or failure of the performance tests;

20.1.2.6 the procedure for the Private Party to remedy any defects that result in a failure to pass any such performance test as notified by the Independent Certifier;

20.1.2.7 the consequences for the Private Party of a failure to remedy any such defects. This will usually result in the Independent Certifier not issuing the Completion Certificate, the Private Party therefore not being able to issue the Availability Certificate, and the Unitary Payment not becoming due; and

20.1.2.8 the timing and procedure for acceptance of Service Commencement if the results of the performance tests are satisfactory to the Independent Certifier. Such acceptance should be evidenced by the issuance of a Completion Certificate.

20.1.3 Only once the Independent Certifier has issued the Completion Certificate should the Private Party be entitled to issue the Availability Certificate declaring the Service Commencement Date. The Unitary Payment should be payable from the Service Commencement Date.

20.1.4 The Institution should generally not seek to impose pre-Service Commencement milestones in the construction or development phase or otherwise accept the delivery of the Works in stages prior to Service Commencement as this may reverse the prescribed allocation of risk transfer.[124] Ideally the Independent Certifier should not be entitled to accept incomplete construction for the purposes of issuing the Completion Certificate. This may affect the risk transfer as the Private Party may seek a waiver of Penalty Deductions as well as payment of the Unitary Payment. In certain PPP projects, however, it may be appropriate to have Service Commencement, despite incomplete construction.[125] Here the Institution must, however, ensure that the Private Party always remains "incentivised" (through the payment mechanism)[126] to complete the outstanding Works.[127]

20.1.5 In certain PPP projects it may be feasible to have phased-in Service Commencement[128] (that is, different buildings or different pieces of plant and equipment being brought into service at different milestones in the PPP project) in which event an appropriate phasing-in of the payments may be justified. In such cases, the Institution may either:

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[124] In projects that are partly funded by means of a capital grant by the Institution or other government entity, it may be necessary to provide for the achievement of construction milestones when capital grant payments will be made to the Private Party.

[125] For example, in an accommodation project the Institution may accept Service Commencement where certain aspects of the construction Works (such as, landscaping) are not completed, as long as these are not integral to the Private Party's ability to provide the main Services.

[126] See Part F:23 (*Services).*

[127] The Institution should seek specific advice from its technical advisers regarding those Services that can be postponed.

[128] Such as road projects.

20.1.5.1 stipulate that full Service Commencement will only be achieved when all phases in the Project reach the required output specification level, which would incentivise the Private Party to bring them all up to the required output specification levels as quickly as possible; or

20.1.5.2 stipulate that partial Service Commencement will be achieved as each phase reaches the output specification level for the Services being provided, so that Unitary Payments reflect the Services actually received.

The choice of which alternative to apply will depend on the overall time period between the final Scheduled Service Commencement Date and full Service Commencement. The longer the period, the more reluctant the Private Party is likely to be to accept the delayed payment involved in the first alternative above.

20.2 **Existing Services**

20.2.1 The acceptance procedure raises other issues if the Private Party takes over existing infrastructure and Services.[129]

20.2.2 The first issue is when and to what extent a Private Party takes responsibility for service delivery of existing services. There are three options available to the Institution:

20.2.2.1 the responsibility for all sites (including existing sites and new sites) is assumed by the Private Party from the Signature Date. This is the simplest option as it minimises complexities regarding the respective responsibilities of the Institution and the Private Party and is, therefore, the prescribed approach. However, where there are concerns about the condition of existing buildings constructed and maintained by third parties, this approach may expose the Private Party to risks that it cannot manage and it may therefore only be willing to accept those risks at a greater cost to the Institution, which may compromise value for money;

[129] For example, the take-over of existing accommodation and related facilities management services.

20.2.2.2 a phased hand-over of the existing site so that the Private Party takes responsibility for these sites only when it is given vacant possession of such sites to commence its required Works. This leaves the Institution responsible for certain sites between the Signature Date and the scheduled Commencement Date of the Private Party's Works on site. Also, the issue of who is responsible for the costs of bringing the sites up to full output specification level has to be agreed. Unless clearly stipulated in the RFP, it is unlikely that the Private Party will easily accept the risk of these costs, especially without having first undertaken an extensive due diligence (see Part D: (*Project Site*); or

20.2.2.3 access (falling short of hand-over) to the existing site for the purpose of carrying out works followed by a hand-over of all existing sites to a Private Party only once they have been brought up to the full output specification standard by the Private Party. This would cause additional complexities as the pre-Agreement arrangements, involving in-house provision of services or a separate contractor, would continue simultaneously whilst the Private Party is carrying out works to bring the sites up to the full output specification standard. This option is not preferred, as it creates potential for disputes over responsibilities. This can be mitigated by specifying in minute detail the interface between these respective roles.[130]

20.2.3 In some cases, the existing condition of buildings may be such that there is a risk of pre-existing non-compliance with health and safety legislation. The Agreement will require the Private Party to conduct the Project Deliverables in accordance with applicable law, thereby exposing the Private Party to legal risk for pre-existing conditions. Even if the funders of the Private Party permit the Private Party to assume all risk for pre-existing conditions (which is

[130] Certain projects have provided for "enabling works" to be undertaken prior to the Signature Date in an attempt to fast-track the Works once they actually begin. These works can be undertaken by the preferred bidder or a third party. While Institutions have tendered to favour "enabling works" as they can fast-track a project, "enabling works" have similar risks to those detailed in Clause Part E:20.2.2.3 and are therefore not advisable. To the extent that this is unavoidable given the specific project, it is preferable that these "enabling works" be undertaken by the preferred bidder as opposed to a third party.

In other projects, the Services adjoin services provided by a third party or the Institution. Again it is imperative that the interface be clearly detailed so as to minimise any disputes.

improbable), they will be reluctant to permit the Private Party to assume this risk during the period before the Service Commencement if the Private Party does not have exclusive possession of the site. In such circumstances, the Institution may consider entering into an ordinary service provision arrangement until the commencement of the Service Period since in a traditional "input" based contract there is no substantial risk transfer. This means that the Institution still retains responsibility for the buildings until Service Commencement.

20.2.4 In PPP projects, ordinarily,[131] no Unitary Payments should be made until the Services are fully available and delivered.[132] In relation to the takeover of existing Services, this principle will not be strictly applied. Here, the Institution can take one of two approaches in relation to Unitary Payments during the transitional period (that is, the period between initial delivery and full Service Commencement). The selection of either approach will depend upon which provides the best value for money:

20.2.4.1 the Institution bases the Unitary Payments to be made before Service Commencement on its current expenditure (pre-Agreement) subject to a performance regime, which entails that no Unitary Payment will be made if, for example, the building is unavailable and Penalty Deductions will be made in the event of poor performance. Payment for those parts of the Services that are delivered will not diminish the significance of full Service Commencement as the Private Party will be incentivised by the performance regime to achieve full Service Commencement; or

20.2.4.2 the Institution makes no Unitary Payment during the transitional period. This maximises the incentive on the Private Party to bring the Facilities up to the full Service Commencement level as quickly as possible, but may impact negatively on value for money because of the cash flow needs of the Private Party.

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[131] This is not the case in revenue-generating projects, for example toll roads.

[132] See Part F *(Services)*.

21 SECURITY AGAINST LATE SERVICE COMMENCEMENT

21.1 Introduction

21.1.1 The Institution may want to ensure that it is protected against late Service Commencement but should do so in a way that provides value for money (taking into account the actual losses the Institution may suffer for late Service Commencement and the necessity and cost of implementing contingency plans).

21.1.2 In considering the issue of late Service Commencement, the Institution should acknowledge that the Private Party is likely to be as concerned as the Institution to commence Service delivery on time, given the cost of alternative funding if the Unitary Payments do not commence and the risk of default under its Financing Agreements if the Unitary Payments are not available to meet scheduled debt service. A delay in the Service Commencement will reduce the Private Party's revenue-earning period. The Private Party is likely to put measures in place to mitigate the effects of late Service Commencement such as insurance or standby debt and/or equity facilities. The adequacy of these should be considered by the Institution in its due diligence (see Part B:4 *(Project Documents)* and should be considered.

21.1.3 If the Institution will not suffer significant losses resulting from late Service Commencement, then the protections allowed by security will not be needed. The issue of security against the late Service Commencement must be considered on a project-by-project basis, regard being had to the particular phases of the relevant project, the specific risks in each such phase, and the Institution's exposure during each such phase and any existing protections already in place that would mitigate these risks, such as guarantees from the Subcontractors to the Private Party, non-payment of the Unitary Payment until the Services commence and any restrictions on the transfer of the Equity for a defined period.[133] The Institution must analyse these during its feasibility study, bearing in mind the specific risk/s that it seeks to mitigate, the type of security available as well as the value for money and affordability considerations. It is

[133] This has been common in many deals with Equity lock-in periods varying from three to five years.

possible to obtain extensive security as protection against late Service Commencement but the Private Party will price the costs of providing such security into its bid. Where it is essential to obtain some form of security given the particular project or particular phase of a project, this may be justified. The different types of security available in order to ensure timeous Service Commencement include performance bonds,[134] liquidated damages and shareholder or sponsor support. At the feasibility stage of each project, the Institution must assess its security requirements in relation to that project. In the RFP the Institution should clearly stipulate the type as well as the amount of any security that it will require from the bidder and request that each bidder cost for such security separately from its total bid price as this will aid in the evaluation process. See Part F:32.5 (*Maintenance in General*) for security regarding the condition of the Project Assets during the Services Period and Part N:61 (*Handback*) for security regarding the condition of the Project Assets immediately prior to the Expiry Date.

21.1.4 The Institution may also want to protect itself against prolonged uncertainties arising from late Service Commencement by having a Long Stop Date after which it may terminate the Agreement.

21.1.5 Once the Parties have agreed on the type of security to be provided, the Agreement must clearly stipulate how the proceeds of such security will be applied. Given that it will usually be called upon in cases where the Private Party has defaulted, the proceeds should first be applied towards rectification of the defect. Thereafter, depending on what has been agreed with the Lenders, the remaining proceeds could be applied toward debt service. The exact nature of this waterfall will depend on the specific needs of the particular project.

21.2 Liquidated Damages

21.2.1 Liquidated damages for late Service Commencement are an ascertained payment representing a genuine pre-estimate of the actual losses or damages the

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[134] Final maintenance bonds and performance bonds are also a type of security available. The former is security to ensure that the Private Party transfers the Project Assets to the Institution at the Expiry Date in the agreed condition. See Part N:61 (*Handback*). The latter provides security for the fulfilment of the Private Party's obligations during the Service Period (See Part F:32.5 (*Maintenance in General)*).

Institution will suffer if the Private Party fails to achieve Service Commencement on time.

21.2.2 If the Institution will not suffer any losses or damages in excess of the amount of the Unitary Payment, taking into account the cost of the Institution procuring the Services from alternative sources, liquidated damages will not be appropriate. If the Institution will suffer such losses, then liquidated damages will only be appropriate to the extent that they will result in value for money for the Institution taking into account all other protections which the Institution will have against late Service Commencement.

21.2.3 To protect against late Service Commencement, the Lenders will usually require the Subcontractors to cover the debt service for the period of the delay through liquidated damages payable to the Private Party and secured in favour of the Lenders. The Subcontractors will, in turn, price the cost of such liquidated damages into the prices they charge the Private Party (for example, in the case of the Building Subcontractor by increasing the Works price to ensure that completion will be achieved on time) and by extending the Works period to include some contingency time. The Private Party will then be more than likely to pass these increases in costs on to the Institution through an inflated Unitary Payment and/or by extensions to the Works period.

21.2.4 Liquidated damages may provide value for money in situations where the costs, which the Institution incurs as a result of the delay, are so great as to justify the increased Unitary Payments. This could be the case where there are "critical dates" for achieving Service Commencement and the costs of the Institution's contingency plan to cope with such critical dates are measurable.[135] Liquidated damages may also be justified where the Institution has contributed a valuable Institution Asset to the Project which could otherwise have been used by the Institution during the period prior to the Service Commencement for some other purpose resulting in the Institution incurring an "opportunity cost".

[135] For example, in accommodation projects where the Institution may have to lease temporary premises to make up for the accommodation that is not available in time.

21.2.5 If the imposition of liquidated damages will not impact severely on the value for money required for a PPP project, the Institution should specify the level of liquidated damages (including any cap) in the RFP in order to enable the bidders to properly price for these damages. This will also assist the Institution's evaluation team in exposing the "real" costs of the bid and improve competitiveness in the selection of the bids.

21.2.6 The Institution should ensure that the level of the liquidated damages reflects a genuine and reasonable pre-estimate of the losses, which the Institution is likely to incur as a result of the delay in the Service Commencement. The amount of the liquidated damages should not be unrealistic, punitive or excessive as this will expose the Institution to the legal risk of non-enforcement of liquidated damages.[136]

21.3 **Construction Bonds**

21.3.1 In the construction industry, construction bonds are generally given by construction contractors as a form of guarantee of completion (the amount guaranteed is usually a percentage[137] of the construction price). A construction bond will usually take the form of an on-demand bank guarantee which can be called by the recipient when, for example, the scheduled Service Commencement Date is not met. Accordingly, the Private Party may well require a construction bond from the Building Subcontractor who will pass through the costs and time effects of providing such a bond to the Private Party who will in turn pass them on to the Institution in the form of an increased Unitary Payment and/or construction Works period. Again, this may not result in the projected value for money, depending on the nature of the Project. The Agreement should clearly stipulate how the funds will be applied, for example, first toward reinstatement and after that toward debt service.

136 This legal risk arises from the provisions of the Conventional Penalties Act, 1962 which does not permit the enforcement of liquidated damages to the extent that the liquidated damages are out of proportion to the prejudice suffered by the creditor (in this case, the Institution) by reason of the breach for which the liquidated damages are being stipulated. The courts are empowered pursuant to section 3 of this Act to reduce the liquidated damages to an extent that they consider equitable in the circumstances.

Unless the Agreement expressly permits the Institution (as creditor) to recover its actual damages in lieu of the agreed liquidated damages, an Institution will not be entitled to recover its actual damages in lieu of its agreed liquidated damages. Since bidders faced with the possibility of such a choice on the part of an Institution will be encouraged to inflate their bid prices, the Institution should consider the implications of such a choice on value for money.

137 Ten percent is typical in South Africa.

21.3.2 If the Private Party defaults during the construction period and the Agreement is terminated, then in many cases the Institution will be left with an asset. The Project Site, the planning consents that will have been obtained prior to the Signature Date, and any construction work undertaken up to termination will all have some value to the Institution. The Institution may, however, be exposed if the Private Party defaults during the early stages of the construction period and the Institution cannot find another party to take over the Project and thus has to incur significant cost in reinstating the Project Site. This scenario is often unlikely in that the Private Party is more likely to invest further money into the Project in order to remedy a problem than it is to walk away and lose its Equity (together with the design and build costs invested up to date). Conceivably the situation could arise where the Private Party decided to abandon the Project if it is in default and faced with substantial rectification costs and if the Lenders decided not to enforce their security. The Institution will need to consider the probability and risk of this occurring on a project-by-project basis.

21.3.3 The need for such bonds are greater when failure by the Private Party to complete the construction works will result in substantial costs to the Institution. It is unlikely that the amount of such bonds will be sufficient to enable the Institution to complete the construction works but it will, at the very least, provide the Institution with sufficient financial resources in order to procure a replacement to complete the construction works. Even if the Institution decided not to proceed with the construction works, it may still incur costs in relation to restoring the Project Site to the condition it was prior to the commencement of the construction. There is, on the other hand, very little need for a bond where the Private Party is handed an existing facility with minimal obligations during the pre-Service Commencement phase.

21.3.4 The Institution should carefully consider the need for construction bonds on a project-by-project basis, regard being had to affordability and value for money considerations. In the event that the Institution requires any such bond the objective should be (having regard to affordability and value for money considerations) to ensure that the bond only covers the period when the Institution is exposed and should automatically fall away when a predetermined and agreed trigger point is reached. This could occur when the Private Party has undertaken construction works that have reached a certain pre-determined value or when the Completion Certificate is issued. The trigger point will, however, depend on the particular project and has to be determined on a case-by-case basis.

21.4 **Sponsor Support**

Sponsor support usually takes the form of undertakings from one or more of the parent companies of the Private Party in favour of the Institution to support the Private Party's obligations to reach Service Commencement on time. This is not a monetary guarantee and usually takes the form of technical support and/or general undertakings to ensure that the Private Party reaches Service Commencement.

21.5 **Long Stop Date**

21.5.1 Service Commencement should not be allowed to be delayed indefinitely due to Private Party Default. This is because and in terms of the PFMA an Institution remains responsible and accountable for the provision of the institutional function that is the subject of a PPP Agreement.

21.5.2 To deal with this, the Institution may impose a Long Stop Date after which the Institution may be entitled to terminate the Agreement.

21.5.3 The Long Stop Date is a date fixed after and by reference to the Scheduled Completion Date and is usually determined on the basis of the length of time the Private Party and/or its Lenders should reasonably be allowed to remedy the Private Party Default. In order to prevent hair-trigger defaults, the Long Stop Date is usually some time after the Scheduled Completion Date (including the remedy period).

21.5.4 The Long Stop Date operates as a disincentive for delay. An alternative approach involves incentives for timeous or early commencement. This alternative approach relies on economic incentives for the Private Party to achieve, and on remedies available to the Lenders to encourage, early Service Commencement.

21.6 Incentives for Early Service Commencement

21.6.1 It may be proposed that "incentive payments" should be paid for early Service Commencement. The term "incentive payment" is, however, misleading since it does not necessarily involve an additional payment over and above the Unitary Payment.

21.6.2 The key issue is that the Institution should not be obliged to accept early Service Commencement and make "incentive payments" unless there is value for money. This must be assessed on a project-by-project basis. Early Service Commencement may provide value for money if there is an urgent demand for the Services or if it would benefit the Institution financially. This might be the case if the early Service Commencement meant that the Project generates additional revenues from end-users or if the Private Party makes savings in which the Institution shares.

21.6.3 However, in a situation where the payment mechanism in an Agreement involves Unitary Payments payable by the Institution and is not based on user charges from end-users, there may be budgetary constraints on the Institution accepting and paying for early Service Commencement.

21.6.4 If an Institution decides to accept early Service Commencement, the Private Party's revenue stream will commence earlier than originally planned. This however should not affect the Expiry Date, which should remain fixed.

22 QUALITY ASSESSMENT

22.1 The Private Party should be under an obligation to implement a quality assessment and management system which meets the requirements of Good Industry Practice and any other applicable standards. This will depend on the nature of the Project.

22.2 The Institution should be entitled as a term of the Agreement to review the Private Party's quality assessment and management system and, further, to rights of inspection to establish the adequacy and accuracy of that system. The Agreement should also provide for the Private Party and Subcontractors to provide all reasonable assistance to the Institution in relation to that review and to respond to and implement results arising from such review.

22.3 No other rights or remedies (such as the right to terminate) should arise from any such review, as deficiencies in the quality assessment and management system will probably manifest themselves through poor performance in the delivery of the Services for which the payment mechanism should provide appropriate Penalty Points and/or Penalty Deductions.[138]

[138] See Part F:23 (*Services*).

PART F: SERVICES

23 SERVICES

23.1 The substance of a PPP is normally the procurement of Services.[139] The Agreement must provide that the Services are to be delivered in accordance with the output specifications in the Agreement and the unavailability of the Services must result in a reduced payment (through Penalty Deductions) by the Institution or, in certain circumstances, no payment (see Part H: (*Payment and Financial Matters)*). The Institution should carefully consider its needs in relation to the Services and the Agreement should clearly detail the output specifications required to be met by the Private Party. Delivery of the Services in a manner that exceeds the output specifications should not be rewarded by means of service credits. While service credits may have a certain appeal, they could result in the output specifications being set too low so as to result in regular service credits being awarded. As service credits often take the form of set-off against Penalty Points, the Private Party can be absolved from responsibility for poor performance in a critical area[140] because it has performed exceptionally well in another area of the Project that is of little consequence.[141]

23.2 The requirements of each Project will determine the exact nature of the Services required and the frequency of the delivery of the Services. The availability of the Services is important because the Institution is required to pay for the Services if they are delivered in terms of the Agreement, even if they are not used (see Part H: (*Payment and Financial Matters)*).

23.3 In procuring Services, Institutions must assess both their current and future requirements. The demand or usage of the Services is a key risk assessment, which has to be determined throughout the Project Term. In drawing up the output specifications for the Services required, Institutions should carefully

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[139] The definition of "Services" is crucial. It must therefore be carefully defined in as much detail as possible. A separate annexure will be necessary.

[140] For example, security in a prison project.

[141] For example, watering the plants in a prison project.

consider their current as well as future requirements in order to minimise the need to change the output specifications. To the extent that this is unavoidable, such changes must be dealt with in terms of the Variations provisions.[142] However, Institutions should, if at all possible, ensure that adequate planning is done to ensure that the long-term demand for the Services can be delivered and all associated risks appropriately managed and mitigated.

24 DEFINITION OF "AVAILABILITY"

24.1 The concept of "availability" (or, at least, its converse) must be defined.[143] The definition should detail the specific conditions that must be met if the Services are to be considered available. The definition must contain conditions which are objective, measurable, reasonable and should not contain criteria which are unachievable or immaterial in the context of the Services as a whole, since payment is dependent on the conditions being met.[144]

24.2 Each Agreement will require different conditions to be inserted into the definition which should, therefore, be as comprehensive as possible. Thus, for example, where catering is required, it will be appropriate to include an acceptable minimum standard. Where minimum standards are met, the failure to deliver in terms of other aspects of the Agreement will not result in the whole Service becoming unavailable but might lead instead to Penalty Deductions (see Part H: (*Payment and Financial Matters)*).

24.3 Unavailability occurs if the relevant key objective criteria determining availability are not satisfied. Each Project will determine unavailability but, generally, unavailability will occur as a result of the non-provision of the agreed deliverables.

24.4 The Agreement should provide for unavailability to be measured following a simple process. Consequently, complex processes that require excessive

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[142] See Part K:50 *(Variations)*.

[143] It may well be appropriate to detail the concept of availability in a Schedule to the Agreement.

[144] In IT projects there are often multiple service measures. In addition, although non-provision of the Services may occur, unavailability may occur (despite provision of the Services) if a level of failure is reached which reduces confidence in the Services to the extent that it cannot be reliably used.

monitoring costs should be avoided. The exact measure of "unavailability" will depend on the nature of the individual Project, the particular times when the Services should be provided and the rectification periods allowed. (See Part J: (*Relief Events, Compensation Events and Force Majeure)*). For critical Services, the lack of Services for less than one hour could be sufficient to trigger "unavailability". For Services that are required during normal working hours, the lack of Services outside normal working hours should not trigger "unavailability".

25 PAYMENT FOR AVAILABILITY

Payment for availability varies from project to project. Different types of PPP projects require different payment mechanisms and allocation of payment depending on the delivery of agreed Services. (See Part H: (*Payment and Financial Matters))*.

26 COMMENCEMENT OF AVAILABILITY

The Agreement must specify the date/s for the provision of the Services and the consequences, if any, where the Services are available either before or after the agreed Service Commencement Date. The Institution may not be obliged to make any Unitary Payment before the scheduled Service Commencement Date unless specifically agreed to in the Agreement. To provide for the management of the delivery of the Services, the Agreement should provide for adequate notice to be given to the Institution and the Independent Certifier in circumstances where the Private Party anticipates that there will be early delivery of the Services and also where the Private Party knows that there will be a delay.[145] The Private Party should not be entitled to issue an Availability Certificate until the Independent Certifier has issued the Completion Certificate.

27 COMMENCEMENT OF UNAVAILABILITY

The Agreement has to determine (for the purposes of determining whether any Relief Event has occurred) when unavailability starts so that notice can be given and

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[145] This is in addition to any notices required in respect of Acceptance and Service Commencement. See Part E: (*Duration and Service Commencement*).

any failures rectified in accordance with the procedures set forth in the Agreement to govern Relief Events, (see Part J:46 *(Relief Events*). The nature of the PPP project will determine the kind of triggers that will assist in the giving of notice.

28 RECTIFICATION

28.1 Unless adequate tolerances are already incorporated in the required performance levels set for the Services, the Agreement should provide for a rectification period within which the Private Party is given the opportunity to rectify the problem without triggering the start of a period of unavailability. The period allowed for rectification will depend on the nature of the Project, the nature of the problem, Good Industry Practice, as well as the importance of the delivery of the specific Services to the Institution. Important factors in assessing rectification are responsiveness, rapid assessment, situation management and rectification in accordance with the Private Party's rectification plan. A failure to meet certain availability criteria may not be capable of rectification, in which case the provisions dealing with termination (see Part N: (*Termination)*) will apply. If the nature of the Project permits, the Private Party should be allowed to provide adequate alternatives, so as to ensure continuity of the delivery of the Services.

28.2 During the rectification period, any Penalty Points should continue to accrue to the extent that the Institution is not receiving the full Services.[146] This will discourage the Private Party from relying on remedying the problem at the last minute.[147]

28.3 If the problem is corrected in the rectification period, then no Penalty Deductions should be made. If the problem is not corrected in the rectification period, then the Services should be deemed to have been unavailable even in the rectification period and Penalty Deductions should be made.

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[146] This depends on the particular payment mechanism used.

[147] In this regard, see Part F:33.11 *(Consequences of Poor Performance).*

29 SERVICE UNAVAILABLE BUT USED

29.1 The Agreement must specify what happens if the Institution continues to use the Services despite the existence of defects, which would otherwise render parts of the Services unavailable. Each Project needs to be considered according to its own Service requirements, but the fundamental principle to be applied is that the Private Party should not receive full payment on unavailability in circumstances where it does not provide the Services to the required standard. The deduction should therefore reflect the difference between the required standard and the actual delivery standard.

29.2 Availability is a critical factor in all PPP projects. Therefore the dispute resolution procedure should contain a mechanism to ensure a quick resolution to any disagreement in this regard. This is usually by means of an Independent Expert. (See Part S:87 (*Fast-track Dispute Resolution)*).

30 RESTORATION OF AVAILABILITY

The Agreement must include a mechanism for assessing when availability has been restored. There should be an agreed procedure by which the Private Party notifies the Institution that the Services are once again "available". While the Institution may want the right to inspect the operations or review documents, it should not be drawn into intricate procedures to confirm availability. Like initial "availability", the Private Party must certify this and, if it is not available, the appropriate penalty or deduction should be triggered. While the Institution has certain statutory functions relating to the monitoring of the Services, their availability or otherwise is the responsibility of the Private Party. The Private Party must ensure that mechanisms have been set-up which will enable it to self-monitor its performance.

31 PLANNED MAINTENANCE

31.1 Ongoing maintenance is required to ensure that the Private Party keeps the Facilities in a condition that meets the required output specifications throughout the Project Term. (See Part A:32 (*Maintenance in General)*). As maintenance is the responsibility of the Private Party, the Private Party should determine the nature, frequency and duration of any maintenance that it requires in order to meet the output specifications as well as fulfil its obligations under the Agreement. The Private Party should prepare a programme for the planned maintenance and provide the Institution with a copy of such programme for its information. The Private Party should be under the obligation to ensure that any and all maintenance that it undertakes does not interfere with the operations of the Institution. To the extent that such interference is unavoidable, the Parties should agree on the programme for such maintenance so as to minimise any such interference. The Private Party should be entitled to amend its maintenance programme. This should, however, not derogate from its obligations to supply the Services under the Agreement.

31.2 There should be no deduction for unavailability during periods when preventative maintenance takes place as planned in the Agreement. The Private Party will have to balance whether maintenance occurring at times other than those agreed will result in the improvement or worsening of its financial position (for example, by postponing or accelerating maintenance).

32 MAINTENANCE IN GENERAL

32.1 Introduction

32.1.1 The Private Party should base its costings on a forecast capital replacement programme of plant, machinery, equipment, fixtures, fittings and/or furniture designed to maintain the Facilities at the required output standards. The Private Party will also consider the means of funding this expenditure throughout the Project Term. The risk associated with assessing what will need replacing, and when and how much this will cost, is one that the Private Party should take and therefore the Institution should not attempt to be prescriptive in this respect.

32.1.2 The Institution will find it easier to achieve this risk transfer if its required output specifications are clearly expressed. Bidders should be allowed to develop their own proposals, which may, for example, incorporate alternative programmes of maintenance where assets with a longer life are used or used differently. An Institution should refrain from imposing its own system of asset replacement on bidders.

32.1.3 A planned preventative maintenance programme is recommended so that both Parties know when parts of the Services are permitted to be "unavailable" without any Penalty Points and/or Deductions. In addition, provision should be made for how emergency maintenance, if any, will be handled so as to ensure minimum interruption of the Services.

32.2 Expiry of the Agreement

As the Expiry Date approaches, the Institution's interest in the maintenance of any Project Asset will become most acute where such Project Asset is to be (or may be) transferred to the Institution on expiry. The Private Party's compliance with the maintenance requirements of such Project Assets will be facilitated by the Institution informing the Private Party of its handover requirements as early as possible prior to the Expiry Date. (See Part A:30.4 (*Surveys)* and Part N:61 (*Handback)).*

32.3 Alternative Use

How, when and to what extent maintenance should be undertaken is the responsibility of the Private Party. If, however, no residual value risk is transferred to the Private Party and there is a possibility that any Project Assets will revert to the Institution on expiry or termination, then the Institution should consider obtaining some security from the Private Party in order to ensure that the Project Assets comply with the requisite standards at handover. (See Part A:32.5 (*Security for Maintenance Obligations)* and Part N:61 (*Handback*)).

32.4 Monitoring

Particularly where the Institution will take over Project Assets at the end of the Project Term, the performance by the Private Party of its maintenance obligations will need to be monitored throughout the Project Term (other than through the performance monitoring system, (see Part F:33.3 (*Monitoring*)) and thus a mechanism needs to be agreed whereby this can be done in as non-intrusive a manner as possible. This is, however, merely a monitoring function on the part of the Institution. Although the Private Party should be informed of any non-compliance with its maintenance obligations found by the Institution, the Private Party should not be obliged to follow any particular course of action as a result of such findings. The purpose of the monitoring from the Institution's point of view is to determine whether and the extent to which Penalty Points should accrue in relation to such non-performance and whether its entitlement to protection under any maintenance bond has been triggered. The Private Party's failure (following notification from the Institution) to fully perform its maintenance obligations will ultimately be reflected in reduced compensation on termination.

Standard Clause

Monitoring Surveys

(a) The Institution may carry out (or procure) a survey of the Project Assets to monitor whether the Project Assets have been and are being maintained by the Private Party in accordance with its obligations under that Clause.[148] This right may not be exercised more often than once every [x][149] years.

(b) The Institution shall notify the Private Party in writing no less than [x] days in advance of the date on which it wishes to carry out the survey. The Institution shall consider any reasonable request by the Private Party for the survey to be carried out on a different date if such request is made at least [7 (seven)] days prior to the notified date and the Private Party (acting reasonably) is able to demonstrate that carrying out the survey on the notified date would materially prejudice the Private Party's ability to provide the Services.[150]

(c) When carrying out any survey, the Institution shall use reasonable endeavours to minimise any disruption caused to the provision of the Services by the Private Party. The cost of the survey shall be borne by the Institution. The Private Party shall give the Institution (free of charge) any reasonable assistance required by the Institution during the carrying out of any survey.

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148 Any such survey should be based upon the required output specifications.

149 This period should coincide with the maintenance cycles specified in respect of any maintenance reserve account or maintenance plan. Affordability considerations should also be taken into account as such surveys have a cost attached to them.

150 There may be other relevant considerations which need to be specified, for example, in some sectors the survey might prejudice security if carried out on a certain date.

(d) *If the results of the survey show that the Private Party has not complied or is not complying with its maintenance obligations then the Institution shall notify the Private Party of the results of such survey.*

(e) *The Private Party shall not be obliged to carry out any maintenance work as a result of such survey. The conduct of the survey shall not relieve the Private Party from the performance of any of its obligations under this Agreement.*

(f) *Any amendment to the Private Party's maintenance programme resulting from the survey shall be at the sole risk and responsibility of the Private Party.*

32.5 **Security for Maintenance Obligations**[151]

32.5.1 The Unitary Payments payable by the Institution include amounts to cover the Private Party's anticipated future expenditure on maintenance. The Private Party will therefore usually build up a maintenance reserve over some years in anticipation of significant capital expenditure in future periods including in the final years of the Project Term, if the Institution is to take over any Project Assets at the expiry of the Agreement.[152]

32.5.2 The Institution should generally not require security in respect of the Private Party's maintenance obligations during the Services Period as poor performance can and should be penalised by the accrual of Penalty Points and Penalty Deductions using the payment mechanism. An exception is permitted for bonds that are used to secure the Private Party's *final* maintenance obligations in relation to the Project Assets where these are to be transferred to the Institution on termination or expiry.

32.5.3 The need for such security in the Agreement has to be measured on a project-by-project basis. Maintenance should, however, generally be at the Private Party's risk and, therefore, the Institution should not attempt

[151] See also, Part E:21 *(Security against late Service Commencement)* for a discussion of alternative forms of Security.

[152] Throughout the debt service period, the Lenders will be concerned with the level of the Private Party's maintenance reserve(s) given that the non-performance by the Private Party of its maintenance obligations will be reflected in the amount of the compensation payable to the Private Party on termination (that is, the compensation will be reduced to reflect the condition of the poorly maintained Project Assets at that time).

Once the Debt has been repaid (which will ordinarily occur well before the end of the Project Term), however, the Lenders will have no interest in the condition of the Project Assets on handover to the Institution.

to prescribe the *quantum* or availability of any maintenance reserve account or other provisions (for example, sinking fund) kept by the Private Party to meet its maintenance obligations. However, details of the balance of such account should be provided to the Institution on an annual basis.

32.5.4 The Institution should generally not require rights over any maintenance reserve account established by the Private Party and should instead ensure that the maintenance requirements are adequately protected through the payment and termination provisions.

32.5.5 As any compensation payable to the Private Party by the Institution on a termination is usually reduced by all cash held by the Private Party, including amounts in any reserve accounts, the Institution should not need any additional rights over the maintenance reserve account and thus the Lenders may be permitted to hold security over such reserve account.

32.6 Security for Final Maintenance Obligations

32.6.1 Where the Project Assets are needed for the provision of essential services after the end of the Project Term, it is advisable for the Institution to request some form of security in relation to the condition of the Project Assets on handover. In this respect, final maintenance bonds have proved to be useful.

32.6.2 Final maintenance bonds are a form of security that have been used in projects where residual value risk has not been transferred to the Private Party. These are typically on-demand bank guarantees that are often costly to procure. They are often issued during the last 12 months of the Project Term and remain valid for a few months after the Expiry Date.

32.6.3 Another option may be to require the Private Party to establish a maintenance reserve account or for the Institution to withhold a predetermined amount from the Unitary Payments in the final months[153]

[153] This period will vary from project to project and may be anything from 12 to 36 months.

of the Project Term and to deposit those into a maintenance reserve account. Reserve accounts can, however, prove to be rather costly as withholding such payments creates a lost opportunity cost which is often greater than the cost of a bond.

32.6.4 A further option may be a compromise between the two approaches where the Private Party is required to provide a final maintenance bond and, only if it fails to do so, may the Institution withhold amounts from the Unitary Payment. This will, however, depend on the specific project and will need to be assessed by the Institution on a case-by-case basis, having regard to, amongst other considerations, value for money. The Institution must clearly assess this risk during feasibility and stipulate its requirements in the RFP. Bidders must be asked to price for this security separately.

33 PERFORMANCE MONITORING

33.1 Introduction

33.1.1 Payment for the performance of the Services to the required output specifications is conditional upon the quality of the performance of the Services (see Part H: (*Payment and Financial Matters)*).

33.1.2 The Agreement should therefore clearly set out:

33.1.2.1 the level of performance entailed by the required output specification;

33.1.2.2 the means by which the Institution is able to monitor the Private Party's performance against such required level; and

33.1.2.3 the consequences for the Private Party of a failure to meet the required level.

33.2 Setting the Performance Level

33.2.1 In order to encourage innovation and optimise risk transfer, the Agreement should specify the required performance level through output specifications and not required inputs (that is, the manner of the Service delivery).[154] In some Projects where there are no appropriate comparators or benchmarks, suitable performance levels will need to be worked out carefully by the Institution and the bidders during the competitive stages of the procurement. The negotiated performance level will form a key element of the risk transfer mechanism. The Institution should pay due attention to the principles set out in Part F:33.2.5 in constructing such a regime.

33.2.2 In setting the performance levels, the Institution should focus primarily on what it requires and not, for example, on what it is accustomed to. If, however, the Institution is already providing the same type of service or part of the Services, this may provide a benchmark against which the Institution may compare the quality and price of the Private Party's bid.

33.2.3 An alternative method is to set the performance levels by reference to the average performance levels of a comparator group made up of other providers of the same or similar services. For example, in prisons the comparator group includes a number of similar establishments and as such the levels of performance by the service providers in those establishments are monitored and an appropriate benchmark thereby being obtained.

33.2.4 The danger with both of these approaches is that if there were to be a reduction in the quality of services elsewhere, then the Private Party would benefit in that it would (even if it were able to perform fully and is unaffected by the reason for a wider deterioration) have an opportunity to perform the Services at a lower level.

33.2.5 Whether benchmarking is appropriate in setting the performance level must be determined by the Institution on a project-by-project basis. Benchmarking is recommended where an industry standard has been set

[154] In IT projects, where technology is constantly changing, the performance level may be set so as to include the concept of "continuous improvement". This will involve a review of the service levels over the Project Term. Here, the Institution should retain the right, subject to agreed controls, to set the performance levels as well as the relationship between the performance levels and the penalty regime.

in respect of services the same as, or similar to, the Services to be provided in terms of the Agreement. This is so in the case of "soft" facilities management services such as catering services. It is, however, not recommended in the case of other facilities management services such as equipment related obligations because the issues regarding replacement and/or renewal of these over the Project Term make it more difficult to rely on benchmarking. In certain circumstances, depending on the nature of the project, it may be appropriate to benchmark the output specifications against the industry standards. This is particularly the case in IT projects. Care must, however, be taken to ensure that such benchmarking does not result in a change in the scope of the Services or the output specifications, since this would constitute an Institution Variation.

33.2.6 As with availability (see Part F:24 (*Definition of "Availability"*)), financiers will be concerned that the performance level required is reasonable and objectively measurable. They will seek to establish that the Unitary Payment will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that allows Debt to be serviced and an equity return to be paid. In considering what a reasonable level is, the Institution should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the Services) to set the required standard in the Agreement at this level. For example, in cases such as operating theatres in hospitals and custody suites in police stations, the optimum 100% standard will always be required and should always be achievable.

33.2.7 In some cases, the Institution may recognise that an optimum 100% standard is not always essential or achievable. As such, the Institution may retain the optimum 100% level but allow a specified leeway before the Private Party suffers Penalty Deductions for unavailability or poor performance. For example, it may be acceptable for the Private Party to incur a certain number of Penalty Points in any specified period before suffering financially where the Services that are provided are at least adequate and poor performance does not materially affect the Project Deliverables.

33.3 **Monitoring Methodology**

33.3.1 There must be a methodology in the Agreement that enables monitoring of the Private Party's performance against the required output specifications in the Agreement so that the performance measurement system can operate effectively.

33.3.2 The monitoring requirements should be set out in the RFP and a full methodology must be included in the bid. The methodology will normally include a substantial element of self-monitoring by the Private Party, subject to periodic Institution review. Additional Institution monitoring may also take place depending on the nature of the Project, for example, clinical staff in a hospital identifying and reporting performance failures. The periodic reports[155] to be provided by the Private Party will be key to the management of the Agreement and to the payment mechanisms, and should be specifically tailored to meet these monitoring requirements. A distinction must be made between the monitoring mechanism formulated and implemented by the Private Party and any actual monitoring undertaken by the Institution as and when it deems necessary in accordance with the Agreement. The Private Party should have primary responsibility for the former and the Agreement should clearly provide for how it will conduct this self-monitoring which will constitute the basis for the calculation of Penalty Deductions.

33.3.3 Monitoring involves the collection and evaluation of data that should be objective, relevant and quantifiable. There should be a clear connection between the data collected, unavailability and the Penalty Deductions for poor performance.

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[155] See Part H:38 (*Reporting Requirements).*

33.4 Commencement of Performance Monitoring

33.4.1 The Agreement must specify the date by which the performance levels are to be achieved. In some projects, such as IT projects, it is recognised that problems are inevitable in the settling-in period, and thus the Private Party can be afforded a degree of flexibility. In other projects such as roads and prisons (where the safety element is crucial), it is essential that the Private Party ensures there are no settling-in problems and that the full performance level is delivered from day one, even if the road or prison is opened in phases.

33.4.2 One approach, which gives flexibility in the settling-in period, is to allow the Private Party to accrue a higher number of Penalty Points during that period before Penalty Deductions are triggered than is allowed during the remainder of the Agreement. Some Contracts (for example, where the Service involves a relocation from existing Facilities into new Facilities) have made successful use of agreed performance levels where Private Parties are allowed a three to six months settling-in period. During this time monitoring takes place, but any Penalty Deductions imposed on the Private Party for poor performance are set at a lower level than is the case once operations are fully established (but, in such cases, this does not affect the Institution's rights to terminate for Private Party Default). A third approach is to award Penalty Points at the rate provided for in the Agreement so that the Institution only pays for that portion of the Services which it receives while increasing the threshold at which Penalty Points will trigger termination.

33.5 Replacement of Subcontractors

33.5.1 Altering the performance regime is not appropriate in the case of replacement Subcontractors, as it is the Private Party's responsibility to manage its Subcontractors and thus the Private Party should bear the risk of their poor performance. The Institution should not be disadvantaged by any change in Subcontractors, so the performance regime should not be interrupted.

33.5.2 Nevertheless, the Institution should allow the Private Party to replace its Subcontractors (subject to the Institution's right to pre-approve the replacement Subcontractors), in order to improve performance and avoid termination. To enable it to do so, the Private Party will normally set a stricter termination threshold (or trigger termination at an earlier point in time) in its Subcontracts than that which applies in the Agreement.

33.5.3 However, if the Penalty Points have already accrued to a level where a minor default could trigger termination, the Private Party may find it impossible to attract a replacement. In Projects where there is only one Subcontractor (or even two Subcontractors) and where the pool of available replacement subcontractors is small, the Institution should permit the suspension of the accrual of further Penalty Points for a limited period of time (for example, two months) after the replacement Subcontractor has been appointed (a "settling-in" period), but only in relation to the Institution's termination remedies and not Penalty Deductions. In order to avoid this relief from termination being abused, the Agreement should prohibit the Private Party from invoking this relief more than twice in the Project Term.

33.6 **Who does the monitoring?**

33.6.1 A key issue to be resolved is who will do the monitoring: the Institution, the Private Party, the Parties acting jointly or an independent third party.

33.6.2 Monitoring should occur at three levels:

33.6.2.1 a systematic self-monitoring by the Private Party through a quality management system measuring performances;

33.6.2.2 a review of the quality management system of the Private Party by the Institution (or an independent third party) including a combination of certain scheduled and random spot checks (with an ability to increase monitoring on repeated failure or poor performance); and

33.6.2.3 the ability for users to report failures (for example, clinical staff and service personnel).

33.6.3 A failure to agree to such a system can cause difficulties, particularly if disputes arise on the issue of whether a Penalty Deduction is to be made from the Unitary Payment.

33.6.4 Monitoring is ultimately the responsibility of the Private Party. This will usually be dealt with as part of the quality management system run by the Private Party. Mechanisms must be in place to ensure that the Private Party collects and provides data accurately. Failure by the Private Party to adequately self-monitor should in itself result in Penalty Deductions or Penalty Points. The method of self-monitoring which the Private Party will use must be agreed on with the Institution in order to ensure that such a self-monitoring system accurately captures any unavailability of the Services. It is essential that the Institution satisfies itself that the self-monitoring system proposed by the Private Party is adequate, since the data collected using this system will ultimately be used to calculate the Penalty Deductions for Unavailability. Where a Private Party provides the information, such information should be in a format stipulated by the Institution[156] the Institution should obtain a right of review (for itself or through an independent third party) to verify the information.

33.6.5 The obligation of the Private Party to self-monitor its performance of the Services should not be confused with the Institution's obligation to monitor in terms of its statutory obligations. Pursuant to Regulation 16, an Institution is required to demonstrate in its application for TA:I that it has the capacity to monitor the implementation and performance of an Agreement. Mechanisms and procedures for such performance monitoring must be established by the accounting officer or an accounting authority of an Institution as soon as the Agreement has been executed in order to ensure that the Agreement is properly enforced.

[156] The Institution must ensure that this is consistent with the Auditor-General's requirements. See the Auditor-General Guidance.

Accordingly, the Institution must ensure that sufficient resources and staff with the right level of experience are available to manage and monitor the Agreement. Some contracts have provided for joint training and development of Institution and Private Party staff to encourage partnership.

33.7 **Who Pays for the Monitoring?**

33.7.1 As a substantial portion of the monitoring is self-monitoring, the Private Party should bear the costs of monitoring. In respect of any reviews of the monitoring system by the Institution, the Institution should bear the costs. However in the event that the review reveals that the Services have not been provided to the required output specifications, the Private Party should bear the costs of that review.

33.7.2 The monitoring arrangements should be proportional to the consequences of Service failure. This will ensure that where it is possible to have a less onerous system it will be in both Parties' interests to do so. Equally, where the consequences of failure are severe, for example, hygiene in an operating theatre, then a rigorous monitoring system should be specified.

33.8 **Addressing Qualitative Factors**

Objective performance criteria should always be used as far as practicable, but other methods of measuring performance may be appropriate in some specific Projects. For example, in some Projects there may be qualitative aspects of performance to which it may be difficult to apply Penalty Points objectively but which are nevertheless important to the users of the Services such as the helpfulness of staff or the quality of catering. Three possible approaches for measuring these type of performance aspects are the use of end-user satisfaction surveys, the use of "mystery shoppers" and sampling:

33.8.1 *End-user satisfaction surveys* - it is difficult to base financial compensation on end-user satisfaction surveys because they are based on individuals' perceptions rather than on objective measurable facts and so the results of such surveys may vary. However, over time they are a useful way of monitoring performance. The Private Party could be obliged in terms of its Agreement to improve end-user satisfaction and, where a survey reveals that particular aspect of the Services falls below the benchmark level, it would have to propose action plans to remedy the problem which should be agreed with the Institution. The advantage of such a system is that if end-users clearly understand the quality of Services contracted for, the feedback obtained can be very useful.

33.8.2 *Mystery shoppers* - a similar approach could be adopted with "mystery shopper" surveys (that is, the use of qualified individuals to test aspects of the Services). This removes the perception aspect of testing since the relevant individuals will apply the same objective standards to all aspects of the Services tested.

33.8.3 *Sampling* - where monitoring is to be done on a sampled basis, the methodology for sampling, including sample size and frequency, should be agreed prior to signing the Agreement.

Certain Projects do not lend themselves particularly to any of these approaches. Regardless of which method is used, the quality of Service aspects must be considered in detail by both Parties and included in the Agreement.

33.9 **Monitoring of Subcontractors**

33.9.1 An Institution may feel the need to use the Agreement to allow it to intervene at Subcontractor level to protect its interest when a Subcontractor is performing poorly (for example, the Institution may want the right to direct or require the replacement of the Subcontractor). This approach is not recommended as it should be for the Private Party to manage its Subcontractors and thus intervention by the Institution will affect the degree of risk transfer achieved. Similarly the Institution should not seek to obtain any direct undertakings or guarantees from the Subcontractors. The Institution should instead rely on the payment mechanism, termination and other rights in the Agreement to address poor performance.

33.9.2 Penalty Deductions under the payment mechanism and, ultimately, the risk of the Institution terminating the Agreement for poor performance, should be a sufficient incentive for the Private Party to manage its Subcontractors' performance. The Private Party will typically ensure it has the right, under the Project Documents, to replace its Subcontractors before the Institution's right to terminate arises under the Agreement. Concerns regarding Subcontractors' performance may be further addressed in the Agreement by requiring a temporary increase of monitoring at the Private Party's expense in specified circumstances as well as requiring the Private Party to provide an acceptable plan outlining how any defects in the Services will be remedied. Both of these measures impose costs on the Private Party and are only acceptable if there has been a persistent and verifiable period of poor performance.

33.10 **Reporting the Results of Performance Monitoring**

33.10.1 The Agreement will need to specify the way in which information regarding performance is reported. Wherever possible, monitoring should allow co-ordination of report production in a way that avoids duplication of effort and all Project participants (including the Lenders) should consider carefully what is needed. The key issues which have to be considered are:

33.10.1.1 what reports are required? By whom? How frequently? Are different reports required by different people in the organisation, for example, contract manager, chief executive officer?

33.10.1.2 is there to be a standard monitoring form or an IT compatible format to present results?

33.10.1.3 how soon after a monitoring period is the report to be received?

33.10.1.4 how often are meetings required between the Institution and the Private Party? Who is required to attend from either Party?

33.10.2 Penalty Points imposed in respect of a specific failure should be the Institution's exclusive remedy in respect of that failure (except to the extent that Penalty Points result in Penalty Deductions or that any termination rights depend on levels of accrued Penalty Points). The levying of Penalty Points will, however, not relieve the Private Party from its obligations to remedy the defect or from any of its other obligations under the Agreement.

33.11 **Consequences of Poor Performance**

33.11.1 The Agreement must set out clearly the consequences of any failure by the Private Party to perform to the minimum standards of the required output specification.

33.11.2 A common approach is for the Private Party to incur a specified number of Penalty Points for each failure, with the number of points incurred varying according to the seriousness of the failure. Penalties should be set based on commercial considerations as opposed to the cost of providing the Services. The Agreement would in this case include a schedule setting out in detail the level of Penalty Points imposed for each failure to meet a required output specification. There should be a clear link between the seriousness of the failure, the number of Penalty Points accrued and the potential financial impact on the Private Party. For example, a failure to clean the exterior of the windows in a hospital should not accrue as many Penalty Points as a failure to maintain the operating theatre in the specified condition. Similarly, different failures in respect of the same part of the Services may also incur different Penalty Points depending upon the context in which it arises. For example, a failure to deliver food in a suitable condition is a more serious failure than a failure to serve food wearing a waiter's uniform.

33.11.3 The accumulation of Penalty Points does not usually have an immediate financial impact on the Unitary Payments payable by the Institution.[157]

[157] This will depend on the type of payment mechanism used.

Generally, Penalty Deductions only start once a certain threshold level of Penalty Points is exceeded. Once performance deteriorates below a particular level, a range of other non-financial mechanisms can be implemented to encourage the Private Party to improve performance. These range from formal warnings to eventual termination for Private Party Default.

33.11.4 In some Contracts it will be more appropriate to have a ratchet mechanism to deal with persistent failure to render a particular aspect of the Services. A simple ratchet mechanism could involve increasing the number of Penalty Points awarded for a particular failure in the Services that recurs too often within a specified period. For example, if x points are awarded for a failure to achieve a particular output specification then (x+3) points may be awarded for each failure over and above a specified maximum number of failures within a pre-defined period.

33.11.5 The ratchet mechanism can be particularly useful where the financial cost of Penalty Deductions which accrue in respect of each such failure is insufficient to provide an appropriate incentive on the Private Party to rectify the failures. A key advantage of a ratchet mechanism, however, is that poor performance which continues for a significant period will be more difficult for other Project participants (for example, Subcontractors and financiers) to ignore, thereby encouraging early action by the Private Party.

33.11.6 If the ratchet mechanism is overly complicated it will be difficult to manage while the inclusion of onerous measures in the pricing mechanism can affect value for money. It is important to tailor the ratchet mechanism to a particular Project in a way that produces the best value for money so as not to introduce perverse incentives. In establishing a suitable system, the Institution will have to be aware of the effect a particular system has on the proposal offered by a bidder. For example, a bid proposal that is capital intensive up-front with reduced consequential life cycle costs will have one optimum approach, whereas one with lower up-front capital costs but with higher life cycle costs will have a different optimum approach (that is, they are most effective at different points in the respective financing plans). It is crucial for the Institution to understand what level of commercial hardship experienced by the Private Party (through the ratchet mechanism) will best achieve the result it desires. An overly rigid approach during negotiations will reduce the scope for innovation by the bidders and so reduce the potential for best value for money to be achieved.

33.11.7 The Penalty Points system should as far as possible cover every aspect of the Services. Where all-encompassing performance standards are not feasible or do not sufficiently address persistent failures, the Institution should consider what recourse it should have against the Private Party for sub-standard performance that is not covered under the required performance standards (see Part N:(*Termination*)).

33.12 Security for Service Obligations

Security for the obligations of the Private Party to perform the Services in the form of a performance bond during the Service Period is not necessary (excluding the last few years if there is provision for a final maintenance bond). Having a bond in place for a period as lengthy as the Service Period is costly and may impact negatively on value for money considerations. The cost is rarely justifiable when one considers that the Institution is entitled to make Penalty Deductions from the Unitary Payment for poor performance.

PART G: PROJECT ASSETS

34 EQUIPMENT AND MATERIALS

34.1 The procurement of the equipment and materials included in the Project Assets and their availability for achieving the required output specifications is a type of 'availability risk' which must at all times in the Project Term be borne by the Private Party. Therefore, the Institution should generally not be prescriptive about the types of equipment and materials to be used in the Project or the methods (often described as "method statements") to be used to satisfy the output specifications in the Agreement.

34.2 The Agreement must state that all equipment and materials that are to be used in the provision of the Services should be of a satisfactory quality. In managing the issue of "quality" and to avoid any confusion during the Project Term it is preferable for quality issues to be decided prior to the Signature Date.

Standard Clause

Equipment Standards:

The Private Party shall ensure that the goods, equipment, consumables and materials used by it or any Subcontractor in connection with the provision of any of the Services (each as a distinct and separate obligation) are:

(a) maintained in a safe, serviceable and clean condition in accordance with Good Industry Practice;

(b) of the type specified in the service level specifications and/or the method statements (where appropriate);

(c) in compliance with any relevant rules, regulations, codes of practice and/or South African standards; and

shall, as soon as practical after receiving a request from the Institution, supply to the Institution, evidence to demonstrate its compliance with this Clause.

34.3 The Agreement must also make provision for the treatment or storage of any necessary hazardous materials, substances and equipment. It should oblige the Private Party to ensure that all hazardous materials, substances and equipment used or stored on the premises are kept in accordance with Good Industry Practice, properly and securely labelled and stored, under appropriate supervision and used only by appropriately trained and competent staff. Furthermore, the Private Party should use all practical and reasonable means to prevent or counteract any unlawful emissions, unlawful discharges or unlawful generation, accumulation or migration of any hazardous substances at or from the Facilities and prevent any circumstances arising which are likely to result in any environmental claims.

34.4 Alternatively, the Agreement should prohibit the installation, keeping and use of any hazardous materials, substances and equipment not necessary for the provision of the Project Deliverables if these may cause damage to the Facilities, bodily injury, endanger health and safety, or may have the effect of transferring the risk associated with them to the Institution.

35 REPLACEMENT AND UPGRADING

35.1 The replacement of obsolescent (used here in the sense of meaning obsolete to the required output specifications) or 'out-of-date' Project Assets is part of the availability or operational risk that should be assumed by the Private Party.

35.2 Hence the Institution should not be prescriptive regarding the timing or manner of replacement.

35.3 However, the Institution should set a standard for replacement based on the output specifications that would permit the Private Party some flexibility in selecting the types of equipment. This standard should be in line with the standard for the relevant industry (or better if a higher standard is offered by the Private Party in its bid while at the same time value for money can still be achieved) and maintained throughout the Project Term.

Standard Clause

Replacement of Project Assets

(a) General Obligations

The Private Party shall at its own cost and risk, provide, deliver, commission, manage, maintain and repair (as the case may be) the Project Assets (or part thereof), including the renewal or replacement of the Project Assets at such times and in such manner:

(i) as to enable it to meet the required output specifications;

(ii) as to ensure that the Private Party is, at all times, able to provide Services;[158]

(iii) without limiting Clause (i) above, as would be required having regard to Good Industry Practice; and

(iv) as required by law.

(b) Replacement Programme

*It is recorded that the Private Party has provided a replacement programme (attached as Schedule [x] ("**Replacement Programme**")) in respect of the Project Assets, detailing in respect of each category of the Project Assets, for the duration of the Project Term, projected replacement and/or upgrading tasks, dates and costs in respect thereof, and shall implement the Replacement Programme in accordance with its terms so as to ensure that it is always able to comply with sub-Clauses (a)(i) to (iv) above. Subject to Clause [x](Equipment Standards) and the output specifications, the Private Party shall be entitled to amend the Replacement Programme from time to time on prior notice to the Institution.*

(c) Removal

The Private Party shall not remove any Project Assets from the Project Site or grant any rights over any Project Assets, until they have been replaced in accordance with Clause (b) save for the purpose of effecting maintenance and repairs to such Project Assets. When any Project Asset has been replaced, the Private Party may remove the replaced Project Asset from the Project Site.

35.4 Non-compliance by the Private Party with the replacement standard at any time during the Service Period should be dealt with through the payment mechanism (that is, Penalty Deductions against the Unitary Payments). The monitoring of the Private Party's compliance with the replacement standard should, therefore, form part of the monitoring regime for all Project Deliverables during the Service Period. If the Institution takes over the Project Assets at the end of the Service Period, then non-compliance by the Private Party with the replacement standard in the final years of the Service Period may also need to be remedied through the exercise of the security (if any) taken to secure the condition of the Project Assets at handback (see Part N: (*Termination: Handback*).

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[158] It may be appropriate, depending on the particular project, to provide that the Services be rendered using 'state of the art' equipment and systems. This requirement does, however, have cost implications and may result in the project being too expensive to ensure value for money for the Institution. If this requirement is adopted, then the term "state of the art" must be defined. The Institution should seek the advice of its technical advisers in this regard.

35.5 The replacement of Project Assets entails significant capital expenditure. An Institution may want to be reassured that the Private Party will have access to funding to meet its replacement obligations. The Institution has two options. Firstly, that the Private Party must source that funding from its financiers. Secondly, the Private Party should establish a reserve account (funded from a prescribed portion of the Unitary Payments) to fund its replacement obligations. Because replacement might be irregular (dependant on technological advancement), a reserve account might be preferred, particularly if the Project is already highly leveraged. The reserve account may also be funded from the proceeds of the sale of replaced Project Assets.

35.6 The Institution should consider whether or not the replaced Project Assets could be utilised by the Institution at other facilities (not forming part of the Project) under its control. For example, replaced Project Assets at a tertiary level hospital could be utilised at other hospitals where they may be needed. If so, then the Institution should ensure that the Agreement provides for appropriate acquisition terms and (if the acquisition is not by way of donation) a methodology for valuing the replaced Project Assets.

36 SECURITY OVER PROJECT ASSETS

36.1 Project Assets not already belonging to the Institution

36.1.1 If the Institution wishes to take over at the end of the Project Term any Project Assets that have been acquired by the Private Party, it may require security over such Project Assets in order to protect its interests in them against the Private Party's other creditors. This is particularly important in managing the risk in PPP projects where equipment is critical for the ongoing provision of services after the end of the Project Term (for example, a hospital project).[159]

36.1.2 Specific legal advice should be sought by Institutions wishing to take any security interests over any such Project Assets regarding the nature of the

[159] This may be very different in the case of a fleet project.

security that would be appropriate. In the case of tangible movable Project Assets, specific advice should be sought regarding the appropriateness and practicality of registering a general notarial bond as opposed to a special notarial bond, particularly if these Project Assets are likely to be replaced often during the Project Term. Where the Private Party will retain any Project Assets at the end of the Project Term, the Lenders will probably take a security interest in those Project Assets although this will only be for the term of the Debt.

36.2 **Institution Assets**

36.2.1 Pursuant to section 3 of the State Liability Act, 1957, no execution, attachment or like process may be issued against any physical state property. That Act does not expressly define "state", but it would appear to exclude (for the purposes of that Act) any public entities that are not financed substantially from the National Revenue Fund or a Provincial Revenue Fund, that is, "government business enterprises" as defined in the PFMA. Accordingly, the giving of security in the form of a bond over physical Institution Assets of all Institutions (other than government business enterprises (whether to the Private Party or the Lenders)) will not be enforceable.[160]

36.2.2 As regards any non-physical property of such Institutions and all property of any government business enterprises that may be made available (as Institution Assets) to any Private Party under PPP agreements, the prescribed approach in this Standardisation is that Institutions should not grant any security whatever over any such Institution Assets to secure their payment obligations under PPP agreements.

36.2.3 It should be borne in mind that the State Liability Act, 1957 regulates the specific issue of the *enforcement* of security over physical state property. The primary legislation regulating the *giving* of security by any organ of state in the national or provincial spheres of government is the PFMA

[160] Such Institutions should bear in mind, however, that the amount required to satisfy any judgment or order made against any such Institution may be paid out of the relevant Revenue Fund.

(more particularly, chapter 8 of the PFMA). Non-compliance by any Institution with chapter 8 of the PFMA in relation to the grant of any security will render the security *invalid*.

36.3 As regards the giving of security by Institutions to Private Parties (or their funders) to secure their payment obligations in respect of Unitary Payments or termination compensation, see Part H:37.6 (*Security for Institution Payments)*.

PART H: PAYMENT AND FINANCIAL MATTERS

37 UNITARY PAYMENTS

37.1 Introduction

The PPP definition in Regulation 16 requires the receipt by the Private Party of a "benefit" (referred to in this Standardisation as a Unitary Payment) for performing the Services or pursuant to its use of any Institution Assets. These Unitary Payments must be either in the form of compensation from a Revenue Fund or user charges or both.

37.1.1 Revenue Fund

37.1.1.1 In terms of the Constitution, no funds may be withdrawn from the National Revenue Fund or a provincial Revenue Fund unless "appropriated" in terms of an Act of Parliament or a provincial Act, as the case may be, or as a "direct charge" that is provided for in the Constitution or an Act of Parliament, or provincial Act, as the case may be.[161]

37.1.1.2 The PFMA does not make any provision for Unitary Payments to be treated as direct charges. Accordingly, the funds required by an Institution (other than a government business enterprise)[162] from the relevant Revenue Fund to make any Unitary Payments that may become due in any financial year must be "appropriated" by the relevant legislature in terms of an Appropriations Act relating to its budgeted requirements for that financial year.[163]

37.1.1.3 In relation to any PPP agreement to which a departmental Institution is a party, the accounting officer of that Institution is responsible for, amongst other things:

[161] See sections 213 and 226 of the Constitution.

[162] Government business enterprises are excluded here because they are not financed (wholly or substantially) from a Revenue Fund, but from their own business operations.

[163] Section 38(2) of the PFMA prohibits the accounting officers of national and provincial departments and constitutional institutions from committing to any liability (for instance, pursuant to a PPP agreement) for money which has not been so appropriated.

(a) reporting to the relevant Treasury at the beginning of each financial year, all expenditure commitments under that PPP agreement anticipated in that financial year;

(b) ensuring that such expenditure commitments are incurred in accordance with the *vote* for that Institution in the Appropriations Act for that financial year; and

(c) preventing irregular and unauthorised expenditure by that Institution.[164] If the expenditure commitments of a departmental Institution under a PPP agreement are not covered (whether at all or sufficiently) in the relevant vote and such expenditure is nevertheless incurred, it will be classified either as "unauthorised expenditure" or "irregular expenditure".[165]

37.1.1.4 In the case of a public entity (other than a government business enterprise), its accounting authority is responsible for, among other things:

(a) ensuring that its expenditure commitments under a PPP agreement in any financial year are included in its budget for that year when that budget is submitted to its executive authority for its *approval;*[166]

(b) ensuring that such expenditure is incurred in accordance with that budget;[167] and

(c) preventing irregular expenditure.[168]

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[164] Section 38(1)(c)(ii) and Section 39(1)(b) of the PFMA.

[165] Section 1 of the PFMA defines "unauthorised expenditure" as an "overspending" (that is, when expenditure exceeds the amount appropriated for the vote or main division of a vote to which that expenditure relates) of a vote or a main division in a vote, or expenditure that is not in accordance with the purpose of a vote or main division of a vote. In contrast, "irregular expenditure" is defined as expenditure that is incurred in contravention of or not in accordance with a requirement of any legislation applicable to the public entity, save for unauthorised expenditure.

[166] See section 53(1) of the PFMA. The budget must be submitted through the accounting officer for the department designated by the executive authority accountable for that public entity at least six months before the commencement of the financial year.

[167] Section 53(4) of the PFMA.

37.1.1.5 In the case of a government business enterprise:

(a) its expenditure commitments in any financial year arising under a PPP agreement must be included in its annual budget for that financial year submitted to the accounting officer designated by the executive authority responsible for that government business enterprise;[169] and

(b) its accounting authority is responsible for preventing irregular expenditure.[170]

37.1.1.6 Institutions should therefore ensure that their expenditure commitments for Unitary Payments required to be made under any Contracts to which they are party are adequately budgeted for in accordance with the requirements of the PFMA.

37.1.2 User Charges

37.1.2.1 Certain PPPs entail the provision of Services to customers or end-users in exchange for tolls, tariffs or other similar charges, for example, a toll road.

37.1.2.2 The setting, levying and collection of any user charges generated under a PPP agreement must meet the requirements for tariff setting and collection in the PFMA and the Treasury Regulations, as well as any sector-specific legislation applicable to a PPP, for example, in the case of a PPP project for the operation of a national toll road, The South African National Roads Agency Limited and National Roads Act, 1998 (the "**National Roads Act**").

37.1.2.3 Tariff setting by institutions (other than public entities) is partly

[168] See section 51(b)(ii) of the PFMA.

[169] The budget must also be submitted to the relevant Treasury at least one month before the financial year. See section 52 of the PFMA.

[170] See section 51(b)(ii) of the PFMA.

governed by Regulation 7 of the Treasury Regulations, which places a duty on the accounting officer of any such Institution to review annually all its tariff-setting structures "that are not or cannot be fixed by any law" when finalising its annual budget and obtaining the approval of the relevant Treasury for any proposed tariff setting structure.[171] Apart from this, neither the PFMA nor the Treasury Regulations regulate tariff setting by public entities. Instead, this is generally regulated by the sector-specific legislation applicable to the public entities concerned. For example, in the case of SANRAL, the National Roads Act places responsibility on the Minister of Transport to set the amount of any toll that may be levied and collected at a national toll road (whether operated by SANRAL or by a Private Party).[172]

37.1.2.4 The PFMA and the Treasury Regulations do, however, extensively regulate tariff levying and collection from a cash and revenue management perspective. The PFMA imposes a general duty on accounting officers and accounting authorities of institutions to take effective and appropriate steps to collect revenues due to the relevant institution and to prevent the under-collection of such revenues.[173] These provisions do not prevent the delegation by any Institution of the levying and collection of user charges, for instance, to a Private Party pursuant to a PPP agreement. However, institutions remain responsible for ensuring that the levying and collection activities assumed by a Private Party are consistent with the minimum standards for effective cash and revenue management imposed on the Institution by the PFMA and the Treasury Regulations as well as any sector-specific legislation.

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[171] The relevant Treasury for the purposes of Regulation 7 is not necessarily the relevant Treasury for the purpose of Regulation 16.

[172] See section 27(3) of the National Roads Act. SANRAL, as the Institution, may make recommendations to the Minister regarding the setting of the toll, rebates or increases and reductions in the toll, but does not have the power to set the toll.

[173] Sections 38(1)(c)(i) and 51(b)(i) of the PFMA. The cash management provisions of Treasury Regulation 15 (applicable to departments and constitutional institutions) and Treasury Regulation 31 (applicable to public entities) impose a duty on the accounting officer or accounting authority, as the case may be, of such an institution to among other things, collect revenue when due and pursuing debtors so as to ensure prompt collection.

37.1.2.5 In contrast to collection, and as a general rule, tariff-setting may not be delegated to a Private Party. Simply stated, this means that an Institution may not agree in its Agreement to delegate any discretion it has to set tariffs to a Private Party.[174] If the Parties to the Agreement require that tariffs be set at a specified level and/or for periodic adjustments in the tariffs at specified intervals and within specified levels, then they should instead consider providing in the Agreement that the Institution will make good any direct losses incurred by the Private Party if the actual tariffs set by government at any time are less than the specified tariffs in the Agreement (including adjustments).

37.1.3 <u>Benefits payable to the Institution</u>

37.1.3.1 Regulation 16 does not expressly require the receipt by an Institution of any fee, rental or other consideration in connection with a PPP (which may sometimes be feasible, particularly where a PPP involves the use of substantial revenue-generating Institution Assets, for example, toll road and eco-tourism projects).

37.1.3.2 However, if a PPP project entails the lease of Institution Assets, then the provisions of Regulation 10.2.3 will apply. This Regulation requires that the letting of state property shall be at "market-related" tariffs, unless the relevant Treasury specifically approves otherwise.[175]

37.2 Payment Mechanism in General

37.2.1 The payment mechanism is the essence of the Agreement as it puts into financial effect the risk allocation between the Institution and the Private Party. It determines the Unitary Payments that the Institution makes to

[174] This is because tariff setting is a legislative function, which government is constitutionally prevented from "fettering" by agreement. There are limited exceptions to this fettering rule. An Institution considering such an agreement for any PPP project in which user charges are a source of revenue generation for the Private Party, should obtain specific legal advice in this regard.

[175] See Treasury Regulation 10.2 and section 76(1)(k) of the PFMA.

the Private Party and establishes the incentives for the Private Party to deliver the Services required in a manner that gives value for money. This Part H:37 (*Unitary Payments)* must be considered in conjunction with Part F:23 (*Services*).

37.2.2 In general terms, the key features of a payment mechanism must be:[176]

37.2.2.1 no payments should be made until the Services are available (but see Part F: (*Services*) for when the Institution may accept incomplete Services);

37.2.2.2 there should be "a single" or "unitary" Unitary Payment for the Services in the sense that the payment should not comprise categories that are linked to the delivery of inputs (for example, labour and material costs), although such categories may be taken into account in relation to permitted inflationary increases (See Part H: 37.2.4);

37.2.2.3 the Unitary Payment should only be paid to the extent that the Services are available (for example, proportionate to the number of available beds in a hospital); and

37.2.2.4 the payment mechanism should seek to make deductions for poor performance so that the Private Party is penalised financially, but deductions should reflect the severity of the failure, so that no Services[177] should lead to no payment, but a minor failure should only cause at most a minor deduction. These should be cumulative so that persistent failures may increase the level of deductions.[178]

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[176] This focuses primarily on projects in which the consideration for the Services is paid by the Institution from its own revenue sources rather than on PPP projects where the consideration is derived from user charges or tariffs, for example, toll roads. The payment mechanism for the latter kind of projects should be considered on a project-by-project basis, subject to legislative requirements.

[177] This may not mean a total absence of Services but is based on the availability criteria.

[178] See Part F:23 *(Services)*.

37.2.3 The Unitary Payment should always be linked to performance and/or availability of the Services.[179] It should not contain a fixed portion to which the Private Party is entitled irrespective of its performance.[180]

37.2.4 In respect of the Services, the Institution should agree upon a fixed Unitary Payment over the lifetime of the Project, subject only to certain inflationary increases. The inflation risk arising in relation to any PPP project must be considered on a project-by-project basis. The following general principles apply:

37.2.4.1 this risk should be shared between the Institution and the Private Party;

37.2.4.2 if there is no inflation-indexation mechanism, the Private Party is likely to incorporate a contingency into its price, which is unlikely to give the Institution value for money;

37.2.4.3 CPIX is the prescribed indexation mechanism for PPPs with a Unitary Payment type mechanism given that annual increases in the budgetary allocations for governmental institutions are based on CPIX. However, whether CPIX is the appropriate indexation mechanism for any PPP should be determined not only with reference to "affordability" but also value for money considerations. Institutions should consider alternative indexation mechanisms at the feasibility study phase of their PPP projects (with reference to affordability and value for money considerations) and should obtain the approval of the relevant Treasury for any index other then CPIX. Whichever index is selected, the choice of index must be specified in the RFP;

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179 This is also applicable when the Private Party's revenue is determined by volume or usage as in the case of a toll road project where the revenue is the aggregate of the tolls that the Private Party is able to recover from road users. The volume risk should however always be borne by the Private Party unless value for money considerations dictate otherwise on a project-by-project basis. It may be possible to agree with the Private Party that any upside in excess of an agreed percentage be shared with the Institution in terms of a pre-determined formula.

180 Such as a minimum portion required to enable the Private Party to meet its debt service obligations to the Lenders.

37.2.4.4 it should also be borne in mind that the "blanket" indexation of all input costs of the Private Party taken into account in the determination of the Unitary Payment may result in the full pass-through of all inflation risk to the Institution which conflicts with the prescribed sharing of inflation risk between the Parties. The Institution should seek specific advice from the relevant Treasury regarding which categories comprising the unitary payment should not be indexed; and

37.2.4.5 if CPIX is selected, provision should be made in the Agreement for any recalculations necessitated by any re-basing of the index (including any replacement index). Any such recalculation must be referred to an independent financial expert for determination.

37.2.5 Save for inflationary increases, there should be no other increases of the Unitary Payment. The Private Party may seek to re-assess the Unitary Payment or specified portions of it at pre-determined intervals during the Service Period in order to mitigate its risk that unforeseen circumstances during the Project Term may result in the Unitary Payment being insufficient to cover its costs and yield anticipated profit margins. This should be resisted given its likely negative impact on value for money and affordability.

37.2.6 To the extent that the output specifications are amended resulting in an increase in the Unitary Payment, this should be dealt with in terms of the Variation Clause.

37.2.7 Depending on the specifics of the particular project, it may also be necessary to provide for "Additional Costs" and "Pass Through Costs". Pass Through Costs constitute costs that are incurred and which the Institution has undertaken to pay. For administrative reasons, it may, however, be agreed between the Parties that the Private Party will pay these Pass Through Costs to the Relevant Authority and that the Institution will reimburse the Private Party. To the extent that there are any such Pass Through Costs, these must clearly be stipulated in the

Agreement together with the procedure for invoicing such costs. These costs will not include any mark-up by the Private Party or any administrative or handling charges. They are direct Pass Through Costs paid by the Private Party for which the Institution will reimburse the Private Party.

37.2.8 "Additional Costs" relate to costs for which the Parties agree that the Institution will reimburse the Private Party. Such reimbursement may include a mark-up on the costs. Alternatively it may only be equivalent to a portion of the costs incurred by the Private Party. This could, for example, relate to the costs associated with the consumption of utilities. The Parties may agree to share the risk in relation to utilities so that, for example, if the cost of utilities[181] increases beyond a certain margin (for example, up to 20%[182] above the price for the previous year, then the Institution could agree to take the risk in respect of, say, 15% of that increase and the Private Party the remaining 85%; if there was an increase of between 20% and 50%, then the Institution could agree to take the risk in respect of, say, 30% of that increase and the Private Party the remaining 70% and so forth).

37.2.9 The Institution should ensure that the Unitary Payment is made timeously and is not unreasonably withheld. Any unreasonable delay in payment of the Unitary Payment should attract interest at the Default Interest Rate.

37.3 **Penalty Deductions**

37.3.1 If the Private Party fails to perform there can be both direct and indirect approaches to remedy the failure.

37.3.2 The direct approach involves deductions (referred to in this Standardisation as Penalty Deductions) from the Unitary Payment and is linked to the availability of the Service (see Part F: (*Services*)). For example, if certain prison cells or hospital rooms do not meet the relevant

[181] This should not cover volume, merely price.

[182] In excess of the inflationary increase.

availability definition, then a deduction may be made from the Unitary Payment. The test should be whether the Service is available and not whether it is used. The Private Party should be incentivised to rectify the default itself. Unavailability for a prolonged period may trigger termination.

37.3.3 The indirect approach depends on the level of performance of the available Service (see Part F:33 (*Performance Monitoring*)) and involves poor performance being addressed by the award of Penalty Points which will vary according to the seriousness and regularity (if a ratchet mechanism is used) of the poor performance. When the Private Party accumulates a certain level of Penalty Points, the consequence is a Penalty Deduction from the Unitary Payment. Once performance deteriorates below a certain level (whether for a single failure or for persistent failure under a ratchet mechanism), or a certain number of Penalty Points are accumulated, then a range of other remedies can be invoked, from formal warnings to, in extreme cases, eventual termination for a Private Party Default.

37.3.4 A combination of deductions for unavailability and under-performance may be used to address failure by the Private Party. Care should be taken, however, to avoid deductions of both types in respect of the same failure.

37.4 The Payment Mechanism

37.4.1 In practice, a variety of payment mechanism structures have been used across sectors and project types (from availability-based mechanisms to service-based and usage-based mechanisms).

37.4.2 A possible model is one that provides a Unitary Payment structure, focusing on broad accommodation areas, rather than individual places for the Services required. The Unitary Payment is then based on a full provision of the overall Services so that the payment mechanism simply determines the deductions for unavailability or poor performance. Availability is defined in terms of being usable and accessible (according to agreed specifications) and different Penalty Deductions are made depending on which area is unavailable. For example, in a hospital project, each section of the hospital may be divided into units and given a weighting depending on its importance. For each failure to provide an available unit there is initially a Penalty Deduction equal to the Unitary Payment multiplied by the relevant weighting. The Penalty Deduction can be based on an escalating tariff so that subsequent days of unavailability of the same space may lead to progressively higher deductions. Poor performance will lead initially to Penalty Points and to Penalty Deductions once a certain level of points has accrued. As the definition of availability here may omit certain key service requirements of the Institution, it may also be appropriate for poor performance of key services to lead to direct Penalty Deductions.

37.4.3 A second possible model is one which follows the principles set out in Part F:33 (*Performance Monitoring*). The Unitary Payment is based on the number of available places or units so that only places or units that are available are paid for. The definition of available places or units incorporates ongoing core Services of the Institution, and thus the Penalty Points regime is only used to address levels of performance which do not impact on the availability of places and/or services that are outside the definition of the core Services. Poor performance leads initially to Penalty Points accruing and, only indirectly, to deductions from the Unitary Payment once a certain level of Penalty Points has accrued.

37.4.4 The Agreement should stipulate a procedure for the invoicing of Unitary Payments including the manner of payment, currency of payment (which must be in Rand), interest on late payment and whether the Unitary Payments are inclusive or exclusive of VAT (See Part S:85 (*Taxation*)).

Standard Clause

Payment

(a) Unitary Payment[183]

The Private Party shall not be entitled to receive any Unitary Payment until the Service Commencement Date.[184] *Subject to the provisions of this Agreement, the Institution shall pay the Private Party the Unitary Payment with respect to all Services each [quarter]*[185] *following the Service Commencement Date in accordance with the provisions of Schedule [x].*

(b) Payment Deductions

Penalty Deductions from the Unitary Payments shall be made as required by Schedule [x].

(c) Invoicing and Payment Arrangements

The invoicing arrangements with respect to Unitary Payments and other payments shall be as follows:

(i) The Unitary Payment shall accrue in arrears in respect of each [quarter][186] *and shall be invoiced and paid in the following [quarter].*

(ii) On the [x]th Business Day of each [quarter] the Private Party shall deliver to the Institution in a form acceptable to the Institution:

*(1) a report (the "**Unitary Payment Invoice Report**").The Unitary Payment Invoice Report shall set out:*

(aa) the Unitary Payment (if any) due in respect of such previous [quarter];

(bb) the aggregate Penalty Deductions (if any) due in respect of such previous [quarter];

(cc) any VAT due and payable in respect of any of the above amounts; and

(dd) the calculation of the application indexation factor[187] *(if any); and*

*(2) a report (the "**Additional Payment Invoice Report**"). The Additional Payment Invoice Report shall set out:*

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183 This Clause will have to be amended in the event of an adjustment to the Unitary Payment to take into account reduced insurance premia as a result of risks that become Uninsurable (See Part I:42 (*Risks that become Uninsurable*)).

184 To the extent that any interim Services are provided prior to the Service Commencement Date, the Clause must be modified appropriately.

185 The frequency of the Service Payments (for example, monthly, quarterly, etc.) will depend on the particular Project and the Institution's budgetary and administrative requirements for processing such payments. This must clearly be stipulated in the Agreement.

186 This assumes that the Unitary Payment is made quarterly. See footnote 184 above.

187 CPIX. See Part H: 37.2.5.

(aa) any other amount due and payable from either Party to the other under this Agreement;

(bb) any VAT payable in respect of any of the above amounts; and

(cc) the calculation of the application indexation factor[188] (if any).

(iii) The Unitary Payment Invoice Report delivered pursuant to Clause (c) shall be accompanied by a performance period report for the relevant [quarter] (prepared by the Private Party) which details the performance for the relevant [quarter] and clearly shows the basis of calculation of each of the amounts referred to in the Unitary Payment Invoice Report.

*(iv) The Unitary Payment Invoice Report and the Additional Payment Invoice Report shall be accompanied by invoices from the Private Party to the Institution in respect of any amounts that are due and payable as contemplated in Clause (c) (Invoicing and Payment Arrangements). ("**Unitary Payment Invoice**" and "**Additional Payment Invoice**").*

(v) If the Unitary Payment Invoice Report and the Additional Payment Invoice Report show a net amount owing by the Private Party to the Institution, then the Institution shall issue an invoice to the Private Party in respect of such amount promptly following its receipt of such Unitary Payment Invoice Report and the Additional Payment Invoice Report and the Private Party shall pay to the Institution the amount shown by such invoice not later than the [x]th Business Day after the Private Party has received such invoice.

(vi) Within [x] Business Days of the end of the Project Term, the Private Party shall render an invoice for the Unitary Payment and additional payments due in respect of the period (or part thereof) from the last invoices up to and including the last day of the Project Term.

(vii) If the Institution does not dispute the Unitary Payment Invoice Report or the Additional Payment Invoice Report, then it shall pay the amount specified in the relevant invoice on or before the Payment Date (as defined below).

(viii) The "Payment Date" for any invoiced amount in a Unitary Payment Invoice or an Additional Payment Invoice shall be the [x]th Business Day after the date on which the relevant report and invoice are presented to the Institution.

[188] CPIX.

(d) *Manner of payment*

All payments under this Agreement shall be made in South African Rand by [insert method] to the recipient [if by transfer of funds to a bank account, then that bank account must be located in the Republic of South Africa] specified in the relevant invoice, quoting the invoice number against which payment is made.

(e) *Disputes*

If either Party disputes all or any part of the Unitary Payments or any additional amounts calculated in accordance with Clause (c), the undisputed amount of the Unitary Payment or any additional amounts shall be paid by the Institution in accordance with Clause (c) and the provisions of this Clause shall apply. The Parties shall use all reasonable endeavours to resolve the dispute in question within [x] Business Days of the dispute arising. If they fail so to resolve it, either Party may refer the dispute for resolution in accordance with the dispute resolution procedure in Clause [x] of the Agreement. Following resolution of the dispute, the Private Party shall withdraw the original invoice/s and issue a replacement invoice/s to the Institution reflecting such agreed or determined amount. Such amount shall be paid by the Institution to the Private Party, together with interest on such amount calculated in accordance with Clause (f) (Late Payments) forthwith after receipt by it of the replacement invoice/s.

(f) *Late Payments*

Each Party shall be entitled, without prejudice to any other right or remedy, to receive interest on any payment not duly made pursuant to the terms of this Agreement on the due date calculated from day to day at a rate per annum equal to the Default Interest Rate from the day after the date on which payment was due up to and including the date of payment.

(g) *VAT*

All invoices submitted by the Private Party to the Institution as contemplated in this Clause [x] (Payment) shall comply with the Value Added Tax Act, 1991.

37.5 **Set-Off**

The Institution should ensure that the Agreement contains an express right for the Institution to deduct Penalty Deductions from the Unitary Payment. In respect of any other amounts owed to the Institution by the Private Party under the Agreement there should, generally, be no right of set-off. However, the Institution should, on termination, be entitled to set-off any liquidated amounts due to it by the Private Party from any amounts due to the Private Party. The Institution should also be entitled to set-off any amounts that are required close to the expiry of the Project Term in order to reinstate the Project Assets to the state they ought to have been in, from amounts due to the Private Party. This applies to liquidated damages and all other debts or liabilities owed to the Institution (including amounts, if any, owed in respect of failure by the Private Party to comply with its maintenance obligations at the end of the Agreement (see Part N:61 (*Handback*)).

37.6 **Security for Institution Payments**

The required approach is that no security (whether over Institution Assets or in the form of a guarantee or suretyship) should be given by any Institution or any other organ of state in respect of any payment obligations (whether for Unitary Payments, indemnified claims, termination compensation or other amounts) of that Institution under a PPP Agreement.

38 REPORTING REQUIREMENTS

38.1 The Treasury Regulations[189] require that PPP Contracts be managed and that mechanisms and procedures be established for monitoring and regulating the implementation and performance of such Contracts, liaising with the Private Party, resolving disputes with the Private Party and monitoring the day-to-day management of the Agreement.[190] The Regulations further provide that the Institution must appoint a Project Officer whose main purpose is to manage the project on behalf of the Institution.

38.2 An integral part of managing the Project is managing the risks associated with the Project by ensuring that the Project is implemented in accordance with the terms of the Agreement. As the Private Party is responsible for the Project, the Institution will not be involved in the day-to-day running of the Project.

38.3 It is, however, crucial that the Institution is at all relevant times aware of the development and progress of the Project. The most efficient way of ensuring that this is done under the circumstances is by requiring the Private Party to

[189] Section 16.8 of the Treasury Regulations.

[190] This does not limit the generality of Part P:75 (*Information and Audit Access)*.

liaise with the Institution on a regular basis. Such liaison should include the appointment by each Party of a liaison officer (in the case of the Institution this person should be the Project Officer) who would be the primary initial source of contact between the Parties. It should also include regular liaison meetings and reporting obligations whereby the Private Party provides the Institution with regular reports covering the various performance areas included in the Services. These reporting requirements should not limit the generality of the reporting requirements referred to in Part P: (*Access to Information*) which is intended to cover reporting to the Institution in order to enable the Institution to comply with its disclosure and other auditing requirements imposed by law. The reporting referred to in this Section should cover the construction and development phase issues relating to progress of the Works, notice of any anticipated delays, the programme for managing any delays, and other issues of importance during the development phase.[191]

38.4 During the Service Period, the reporting requirements should cover the Private Party's performance and/or performance failures in relation to the output specifications of the Project.

38.5 The reporting obligations are essential in order to ensure that the Project risks are managed in accordance with the provisions of the Agreement. The consideration of appropriate risk transfer also requires that the Institution ensures that the Private Party, if a company, complies with its obligations in terms of the Companies Act and that the Private Party does not take any action or omit to take any action that may adversely affect the legal status and financial stability of the Private Party.

38.6 The Agreement must contain detailed provisions relating to the reporting and disclosure obligations of the Private Party. These obligations must mirror the

[191] The nature and type of reports required will depend on the specific Project.

Institution's disclosure obligations to the Accountant-General[192] as well as the Auditor-General.[193]

[192] See the Accountant-General Guidance.

[193] See the Auditor-General Guidance.

PART I: INSURANCE

39 INTRODUCTION

39.1 In traditional "input" based procurement, government self-insures against those risks retained by it which are not passed onto the private sector. Since, in PPP projects, a greater range of risks is transferred to the private sector, and given the nature of the financing arrangements behind most Contracts (whether project financed or primarily corporate financed), self-insurance by government for the full range of risks is not a practical or appropriate option.

39.2 As the Lenders take some performance risk in a project financed PPP, they will usually have extensive insurance requirements for the full term of the Debt. The Institution should not, however, rely on the Lenders' insurance requirements to determine the adequacy of the Private Party's insurance for the Project. In any event, since the insurances required for the Project are generally for the benefit of both Parties and the costs of such insurances are generally passed through to the Institution (in the Unitary Payment), the Institution will need to satisfy itself as to the adequacy of the insurances and their cost effectiveness. Further, in contrast to the Lenders, the Institution will need to satisfy itself as to the adequacy of the insurances for the *full* Project Term, not just the term of the Debt which is shorter.

39.3 It is essential for the Institution to seek its own insurance advice on the insurance requirements to be imposed on the Private Party under the Agreement. This should be done at the feasibility study phase of a PPP project, the bid phase and the negotiations phase with the successful bidder.

39.4 The main issues are:

39.4.1 whether and the extent to which the Institution should require the Private Party to obtain and maintain certain insurances as a means of managing particular risks;

39.4.2 how substantial increases in insurance premia over the Project Term (not covered by the escalation in the Unitary Payments permitted under the inflation indexation mechanism in the Agreement) should be dealt with;

39.4.3 what should happen if any required risks becomes uninsurable;

39.4.4 the control of the defence of any litigation relating to an insured event; and

39.4.5 ensuring that the proceeds of any claim under any required insurance are used correctly by the Private Party.

40 INSTITUTION'S REQUIREMENTS

40.1 General

40.1.1 In order to optimise risk transfer, the Institution should allow the Private Party to manage its insurance arrangements as far as possible. In general terms, the Private Party will be expected to insure in accordance with Good Industry Practice.[194]

40.1.2 There will be a number of required insurances, however, which the Institution will want to know are being taken out and maintained by the Private Party, to ensure that insurance proceeds are available to cover certain types of claims. These required insurances should include *material damage insurance* for both the construction phase and operations phase of the Project, and *legal liability insurance*, including third party liability insurance, employer's liability insurance and directors' and officers' liability insurance, for both phases.

40.1.3 Generally, the Institution should ensure that the required insurances do not include any insurance that will not directly benefit the Institution such as any professional indemnity insurance. The only exception here is delay in start-up and business interruption insurances which are usually

[194] What constitutes Good Industry Practice for the purpose of the insurances should be part of the advice sought by the Institution from its own insurance adviser.

maintained for the benefit of the Lenders in order to service the Debt during any reinstatement period following an insurable event. Although this insurance will not directly benefit the Institution, it should nevertheless be included in the required insurances under the Agreement to cover the Private Party's obligations to the Lenders to service the Debt and to cover the expenditure requirements of the Private Party incurred in the provision of the Services, but not to cover any loss of profits to the Private Party. It is therefore essential for the Institution to ensure that the cost pass through of this insurance to the Institution does not cover any return on Equity or repayment or payment of Shareholder Loans.

40.1.4 The Institution should further ensure that the uninsurability relief afforded to the Private Party (see Part I:42 (*Risks that Become Uninsurable*)) only extends to those risks covered by the required insurances (including, but only if this provides value for money, any delay in start-up and business interruption insurances; provided, however, that this protection is limited to the Debt portion of such insurances), and not to any other risks even if these risks are covered by insurance which the Private Party elects (or is required by its funders) to obtain, namely, so-called "discretionary" insurances. For example, the Lenders may require the Private Party to take out professional indemnity insurances. The unavailability of such discretionary insurances is a risk that Lenders regularly accept on project financing. Accordingly, if this insurance subsequently becomes unavailable, the Institution should not be required to give the Private Party uninsurability relief in respect of such insurance.[195] However, the uninsurability relief should not extend to any non-vitiation protection included in the required insurances since the Institution should not support the Private Party against its own negligence or that of its Subcontractors.

40.1.5 The insurance requirements for a PPP project should reflect the degree of risk transfer, the ability of the Private Party to make the premium

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[195] Section I:40 (Risks that become Uninsurable).

payments (relative to the size of the risks), value for money considerations and the specifics of the PPP project. There are standard insurances that are typically required during the construction and operating phases of all projects. The scope of insurances (the risks, the exclusions, the endorsements, the amounts of cover and the deductibles) will vary from project to project and sector to sector.[196] The Institution and its insurance and financial advisers must focus on the value of the risks to be insured when assessing the required appropriate level of insurance.

40.1.6 If the Institution wishes to increase the limits or scope of the insurances during the Project Term, then this should be treated as an Institution Variation (see Part K: (*Changes in Law and Variations*)).

40.1.7 As government normally self-insures, there should be no requirement for any insurance to cover those risks that are retained by an Institution. It may, however, be reasonable for the Institution to seek third party public liability insurance where the Parties have shared access to the Project Site and/or there is substantial risk of third party claims. This should be checked with the relevant Treasury when TA:I is being sought.

40.1.8 The Institution should be a co-insured for its own interests (where it has an insurable interest) and require that its interests be noted on the insurances taken out by the Private Party. This should be acceptable to the Private Party.[197] The Institution should be aware that the Lenders too will want to be named co-insureds under all insurances obtained for the Project.

40.1.9 The Institution should consider the value for money benefits of requiring the Private Party to take out non-vitiation protection, if available, in respect of certain required insurances (for example, material damage

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[196] Salient information as to the scope of the required insurances should be included in a Schedule to the Agreement. This should include the letter(s) of undertaking of the broker appointed to place the required insurance.

[197] This is a much stronger position for the Institution than being named as "loss payee" under the policy, as a co-insured can make the claim itself and is not (as in the case of a "loss-payee") reliant on the insured party making the claim.

insurance). Non-vitiation protection allows the Institution to claim as a co-insured under a policy even if the insurer would have been able to avoid a claim made by the Private Party on the basis that the Private Party withheld material information from the insurer (for example, the Private Party does not inform the insurer that it is intending to use highly flammable substances).[198] The Lenders may also require non-vitiation protection, if available. However, absence of such protection should not be covered by the relief given to the Private Party in respect of uninsurability of insurances.[199] The Institution should obtain specific advice from its own insurance adviser as to what (if any) non-vitiation protection is available.

Standard Clause

<u>*Insurance*</u>

(a) The Private Party shall, prior to the Service Commencement Date, take out and shall thereafter maintain or procure the maintenance of the insurances described in Part [x] of Schedule [x] and any other insurances as may be required by law. These insurances must be taken out and become fully effective in each case not later than the date on which the relevant risk commences.[200]

(b) The Private Party shall with effect from the Service Commencement Date (or earlier if the relevant risks commence before that date) take out and maintain or procure the maintenance of the insurances described in Part [y] of Schedule [x] and any other insurances as may be required by law.[201]

(c) No Party to this Agreement shall take any action or fail to take any action, or (in so far as it is reasonably within its power) permit anything to occur in relation to it, which would entitle any insurer to refuse to pay any claim under any insurance policy in which that Party is an insured, a co-insured or additional insured person.

(d) The insurances referred to in Clauses (a) and (b) shall:

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[198] The vitiation of an insurance claim resulting from the Private Party's non-disclosure of material information is not a Private Party Default *per se*. If this occurs, the Private Party must be obliged to self-fund the loss not covered as a result of the vitiation. Its failure to do so and to reinstate the Project Assets in question may, depending on the materiality of the damage, be a material breach of a material term and expose the Private Party to the risk of termination for Private Party Default.

[199] Part I: (*Insurance: Risks that Become Uninsurable*).

[200] These are the construction or development phase insurances and must be required insurances only, that is, material damage insurance and legal liability insurance. The insurance schedule should specify the dates by which these insurances should be effective.

[201] These are the operational insurances and must be required insurances only. In some projects the operation phase may overlap with the construction phase and as such the insurance requirements will need to be tailored accordingly.

(i) (subject to Clause (e) below), name the Private Party as co-insured with any other party maintaining the insurance;

(ii) provide for non-vitiation protection in respect of any claim made by the Institution as co-insured in respect of Part [z] of Schedule [x]. If non-vitiation protection is unavailable when any such insurance policy is first placed, then the Private Party shall procure that the [Insurance Broker] investigates whether any non-vitiation protection subsequently becomes available prior to each renewal of the policy and provides written confirmation promptly upon the renewal thereof as to the unavailability thereof to the Institution. If any non-vitiation protection subsequently becomes available, then the Institution shall be entitled to require the Private Party to procure such protection and the costs thereof shall be borne by the Private Party;

(iii) contain a clause waiving the insurers' subrogation rights against the Institution, its employees and agents;

(iv) provide for [x] days prior written notice of their cancellation, non-renewal or amendment to be given to the Institution; and

(v) provide for payment of any proceeds to be made by insurers in accordance with Clause [x] (Reinstatement).

(e) The insurances referred to in Clauses (a) and (b) shall name the Institution as a co-insured for its separate interest.[202]

(f) The Private Party shall provide to the Institution:

(i) copies on request of all insurance policies referred to in sections (a) and (b) (together with any other information reasonably requested by the Institution relating to such insurance policies) and the Institution shall be entitled to inspect them during ordinary business hours; and

(ii) evidence that the premia payable under all insurance policies have been paid and that the insurances are in full force and effect in accordance with the requirements of this Clause [x] (Insurance).

(g) Renewal certificates in relation to the insurances referred to in sections (a) and (b) shall be obtained as and when necessary and copies (certified in a manner acceptable to the Institution) shall be forwarded to the Institution as soon as possible but in any event at least 10 days before the renewal date.

(h) If the Private Party is in breach of Clause (a) or (b) above, the Institution may pay any premia required to keep such insurance in force

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[202] This will only be possible on policies for which the Institution has an insurable interest (not, for example, employer's liability or professional indemnity insurance). Where it is not possible for an Institution to be a co-insured then the Agreement should instead record that the Institution is a co-payee.

or itself procure such insurance [203] *and may in either case recover such amounts from the Private Party on written demand.*

(i) *The Private Party shall give the Institution notification within [x] days after any claim in excess of R[ ] under any of the insurance policies referred to in this Clause accompanied by full details of the incident giving rise to the claim.*[204]

(j) *Neither failure to comply nor full compliance with the insurance provisions of this Agreement shall limit or relieve the Private Party of its liabilities and obligations under this Agreement.*

(k) *The insurance premia referred to in Clauses (a) and (b) shall be the responsibility of the Private Party.*

40.2 **Mechanism to Increase Insured Amounts**

40.2.1 There must be a mechanism to ensure that the insured amount increases over the full Project Term in order to keep pace with inflation.[205] This is commonly done through the inflation indexation mechanism. Alternatively, it may be by agreement on expiry of policies (and, failing agreement, resort to dispute resolution).

40.2.2 Index-linking can cause a problem for legal liability insurance if it cannot be bought in odd amounts although this is normally dealt with by rounding up annually to the nearest whole insurable amount.

40.3 **Insurers**

40.3.1 The placing of insurance is subject to the Short-Term Insurance Act, 1998, which requires that all short-term insurance be placed with insurers registered in terms of that Act (being only South African companies) or Lloyd's.

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203 This will not be possible for insurances in respect of which the Institution has no insurable interest.

204 In PPP projects where many third party claims are likely, the Institution can agree upon a minimum amount below which it is not notified. If this is done, it may be necessary for the Institution to be notified of important claims (for example, accident and injury based claims).

205 This will not be necessary where the insured amount is an unspecified amount (for example, the reinstatement cost of fixed assets or the market value of movables) rather than a specific sum (as is usually the case for legal liability insurance).

40.3.2 The Agreement should require that all required insurances are placed by the Private Party with permitted insurers in accordance with applicable law.

40.3.3 That Act also limits access to the worldwide insurance market if insurance is available in South Africa. In other words, any required insurance must be placed in South Africa first if it is available here and resort may only be had to the worldwide insurance market if the insurance is not available here.

40.4 Changes in Terms of Insurance Policies

The Institution should ensure that insurers are under an obligation to inform the Institution of changes in the policy. This should be confirmed by the insurance broker in its letter confirming that the required insurance has been placed.

41 INCREASES IN INSURANCE COSTS

41.1 The risk of substantial increases in the rates at which the premia for the required insurances are calculated (not covered by the escalation in the Unitary Payment permitted under the inflation indexation mechanism in the Agreement) should generally be borne by the Private Party.

41.2 Increases in the rates applicable to the Private Party's discretionary insurances should also be borne by the Private Party.

41.3 The Institution should ensure that such risk is not passed through to the Institution.

41.4 The only exceptions here are increases in the rates for the required insurances resulting from Institution Variations. This risk should be borne by the Institution and taken into account in the price variation provisions. Increases resulting from Variations by the Private Party must be borne by it.

42 RISKS WHICH BECOME UNINSURABLE

42.1 The Agreement must address the situation where a risk required to be insured against (that is, a risk to be covered by a required insurance) and which was previously insurable becomes uninsurable. The approach adopted in this Standardisation concentrates on the availability of insurance cover for a particular risk and not the availability of cover upon particular terms or with particular levels of deductibles.

42.2 The consequences of uninsurability of any risk (ranging from Private Party Default to the Institution accepting liability for occurrence of the event) will depend on whether either Party was responsible for the uninsurability of that risk and whether other service providers carrying on similar businesses to the Private Party would cease to carry on uninsurability of that risk.

Standard Definition

*"**Uninsurable**" means, in relation to a risk, either that:*

(a) the required insurance is not available in the worldwide insurance market with reputable insurers of good standing in respect of that risk; or

(b) the insurance premium payable for insuring that risk is at such a level that the risk is not generally being insured against in the South African insurance market.

42.3 The Private Party should not be required as a term of the Agreement to insure risks that are Uninsurable. If, however, a key insurance risk becomes Uninsurable, the Private Party will be in breach of the Agreement where it has *caused* the relevant insurance to be unavailable. This should ultimately give rise to a termination right on the part of the Institution for Private Party Default if the uninsured event arises and the Private Party does not have the funds necessary to cover the loss and/or reinstate the Project.

42.4 Generally, the Uninsurability of any risks for reasons outside the Private Party's control should also not then entitle the Institution (or, for that matter, the Private Party) to terminate the Agreement. If any risk becomes Uninsurable for reasons outside the control of the Parties, then the Parties should endeavour to agree alternative means by which that risk can be managed. If, however, no agreement is reached and the risk reverts to the Institution, then the amount of the premium (including the premium previously paid) must be deducted from the Unitary Payment. If the risk occurs, then the Institution can choose either to pay an amount equal to the insurance proceeds that would have been payable had the risk been insurable (in which case termination will not occur) or terminate the Agreement and pay to the Private Party compensation equivalent to the amount payable to it on *Force Majeure* termination.

Standard Clause

Uninsurable Risks

(a) *If a risk usually covered by the insurances in Part [z] of Schedule [x],[206] becomes Uninsurable then the Private Party shall notify the Institution within [x] days of the risk becoming Uninsurable.*

(b) *If both Parties agree, or it is determined in accordance with Clause [x] (Fast-track Dispute Resolution), that:*

  (i) *the risk is Uninsurable;*

  (ii) *the risk being Uninsurable is not caused by the actions or omissions of the Private Party or a Subcontractor; and*

  (iii) *other service providers carrying on businesses similar to the Project would cease to operate their business as a result of such Uninsurability,*

  then the Parties shall meet to discuss the means by which the risk should be managed (including by way of self-insurance by either Party).

(c) *The Private Party shall bear the onus of proving the circumstances in Clause (b)(i) to (iii).*

(d) *If the requirements of Clause (a) are satisfied, but the Parties cannot agree as to how to manage the risk, then the Agreement shall continue.*

[206] This Schedule should refer to all the required insurances including any delay in start-up and business interruption insurances but only to the extent of the debt portion thereof, but excluding any non-vitiation protection included in the required insurances. The Private Party's discretionary insurances (for example, any professional indemnity insurances) should be excluded.

(e) *On the occurrence of the risk (but only for as long as such risk remains Uninsurable) the Institution shall (at the Institution's option) either pay to the Private Party an amount equal to the insurance proceeds that would have been payable*[207] *had the relevant risk continued to be insurable and the Agreement will continue, or an amount equal to the amount set out in Clause [x] (Compensation: Termination on Force Majeure) and the Agreement will terminate.*[208]

42.5 In those Projects where there is a high risk of substantial third party claims (such as a hospital project), and bidders are not willing to agree to the continuation of any such Project if any third party risks become Uninsurable or are only willing to do so in a manner that impacts negatively on the affordability or value for money of the Project, the Institution should consider agreeing to the automatic termination of the Project after the Uninsurability of the third party risk and the circumstances in (b)(i) to (b)(iii) of the Standard Clause been proven, unless the Institution agrees itself to insure the Project against such third party risk.

42.6 If the Institution agrees to this, and the third party risk arises and that risk is still Uninsurable at that time, then the Institution must discharge the claim and may at any time thereafter (particularly, if the cumulative effect of the Uninsured third party claims proves to have negative implications for the continued affordability and value for money of the Project), terminate the Agreement. The termination compensation in these circumstances should be limited to the amount of the Debt.

43 CONTROL OF THE DEFENCE IN LITIGATION ON AN INSURED EVENT

43.1 The Institution may wish to control the defence of any litigation against the Private Party that is likely to have implications for the Institution itself or wider government. If the Institution is likely to become a co-defendant in the relevant litigation or a defendant in a number of similar litigations based on the precedent in law set by the relevant litigation, it is likely to want to control the litigation from an early stage. This may involve prolonging litigation in order to establish a clear precedent instead of settling out of court. Alternatively, the

[207] This amount should exclude any deductible to which the insurances would be subject.

[208] Part N: (*Compensations: Termination on Force Majeure*).

Institution may wish to settle the litigation as soon as possible for public policy reasons and, in such cases, these will override commercial considerations (this may be the case, for example, in prison and hospital projects).

43.2 Insurers in the South African insurance market will, however, usually expect to be in control of any litigation which may lead to a claim under one of their policies. They will be reluctant to pay out for claims where they have no control of the defence. The degree of control required by the Institution should be examined on a project-specific basis and advice in this regard should be sought by the Institution from its insurance adviser.

43.3 Generally, the Institution should expect to assume some liability for litigation costs if it wishes to insist on controlling such litigation. In practice, it is extremely difficult to determine what such liability should be. In principle, the Institution should be liable for any difference between what the insurer would have paid and the final amount settled or decided. It would be very hard to establish, however, what amount would have been an acceptable settlement to all parties (including the plaintiff). In practice, the Institution may find that it is obliged to take on the majority, or even all, of the relevant litigation costs in return for the right to control the defence.

44 APPLICATION OF INSURANCE PROCEEDS

44.1 Material Damage Insurance

44.1.1 Reinstatement

44.1.1.1 If an event covered by any material damage insurance included in the required insurance for a PPP project occurs and any Project Assets require reinstatement,[209] the Institution may decide to change the service requirement. This may entail something other than exact reinstatement. If it does so, the cost of reinstatement may be more than the cost of exact reinstatement. Where

[209] During the period of any requisite replacement or reinstatement, the Institution should not be in a position to terminate the Agreement by virtue of the event that gave rise to the need for replacement or reinstatement.

insurance proceeds do not cover the full reinstatement, and the additional cost is due to an Institution Variation (and not under-insurance by the Private Party), then the extra cost must be funded by the Institution in accordance with the change in Service mechanism (see Part K: (*Changes in Law and Variations*)).

44.1.1.2 Although the material damage insurance cover should provide for exact reinstatement, the Private Party should nevertheless be required to negotiate insurance to reflect the fact that the Institution's requirements may change after an insured event occurs and that there may be a requirement for something other than exact reinstatement.[210]

44.1.1.3 In practice, the Parties will negotiate whether (and how) to reinstate the Project after the occurrence of an insured event. Accordingly, the Agreement should set out provisions regarding how the Parties will agree to a plan for the reinstatement of the Project. The Agreement must be clear as to the remedy in the event of disputes over any reinstatement plan.

44.1.1.4 The Institution should ensure that all material damage insurance proceeds are utilised in accordance with the agreed reinstatement plan. Additionally, the Institution must ensure that upon termination of the Agreement for whatever reason, the Institution receives the benefit of any such insurance proceeds so that it can continue with the reinstatement of the Project.[211] In many instances, the Private Party will be forced to replace or reinstate prior to the settlement of the insurance claim. It may therefore be more prudent to stipulate that the proceeds of the insurance shall be applied for the benefit of the Project if no longer directly

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[210] If the Institution decides to reinstate with a lower level of service requirement following an insured event, the Unitary Payment should remain the same unless compensation is paid to the Private Party. The Institution should also be aware of the fact that a decision not to reinstate fully may impact upon the amount of insurance proceeds recoverable.

The Institution should confirm in advance whether or not the insurance covers the full reinstatement costs or only market value. If the full reinstatement costs are not covered, any shortfall should be for the Private Party.

[211] This is particularly important if the Agreement is terminated for Private Party Default and the Institution elects (and is able) to retender the Agreement.

applicable to the insured event in terms of the reinstatement plan.

Standard Clause

<u>Reinstatement</u>

*(a) Subject to Clause [x] (Economic Test),[212] all insurance proceeds received under any policy referred to in Part [x] of Schedule [x] ("**Material Damage Policies**") shall be applied to repair, reinstate and replace each part or parts of the Project Assets in respect of which the proceeds were received.[213]*

*(b) All insurance proceeds paid under any Material Damage Policy in respect of a single event (or a series of related events) in an amount in excess of R[minimum level] (indexed to [CPIX]) shall be paid into a bank account to be opened in the name of both Parties (the "**Joint Insurance Account**").[214]*

*(c) Subject to the Clause [x] (Economic Test),[215] where a claim is made or proceeds of insurance are received or are receivable under any Material Damage Policy in respect of a single event (or a series of related events) (the "**Relevant Incident**") in an amount in excess of R[the same figure as in Clause (b) above] (indexed to [CPIX]):*

*(i) the Private Party shall deliver as soon as practicable and in any event within [x] days after the making of the claim a plan prepared by the Private Party for the carrying out of the works necessary (the "**Reinstatement Works**") to repair, reinstate or replace (the "**Reinstatement Plan**") the assets which are the subject of the relevant claim or claims in accordance with Clause (d) below. The Reinstatement Plan shall set out:*

(aa) if not the Building Subcontractor, then the identity of the person proposed to effect the Reinstatement Works, which shall be subject to the prior written agreement the Institution; and

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212 See Part I:44.1.2.2

213 The Private Party will be liable to make good any deductibles allowable in terms of such policies.

214 This account must be excluded from the Lenders' security regime, although the Lenders (or their agent) may be co-insureds under these policies.

215 See Part I:44.1.2.2.

(bb) the proposed terms and timetable upon which the Reinstatement Works are to be effected (including the date that the Project will become fully operational), the final terms of which shall be subject to the prior written agreement of the Institution;

(ii) provided that the Institution is satisfied[216] *that the Reinstatement Plan will enable the Private Party to comply with Clause (d) below within a reasonable timescale:*

[216] The Institution should be aware that following any material damage to the Project, the Private Party will only be permitted to claim under any business interruption or loss of profits insurance if the insurer is satisfied that the Private Party is using its reasonable endeavours to reinstate. Accordingly, the Institution's response to the proposed Reinstatement Plan should be reviewed by the Institution as a matter of priority and the Institution should respond to the Private Party within a reasonable period of time.

(aa) the Reinstatement Plan will be adopted;

(bb) the Private Party shall enter into contractual arrangements to effect the Reinstatement Works with the person identified in the Reinstatement Plan agreed to by the Institution;

*(cc) prior to the earlier to occur of the Termination Date and the Expiry Date, any amount standing to the credit of the Joint Insurance Account (the "**Relevant Proceeds**") (together with any interest accrued) may be withdrawn by the Private Party to the extent required to enable it to make payments in accordance with the terms of the contractual arrangements referred to in Clause (bb) above, and to meet any other reasonable costs and expenses of the Private Party for the sole purposes of funding the Reinstatement Works. Following the earlier to occur of the Termination Date and the Expiry Date, the Institution may withdraw amounts standing to the credit of the Joint Insurance Account for the purposes of funding any Reinstatement Works;*

(dd) the Institution agrees and undertakes that, subject to compliance by the Private Party with its obligations under this Clause, and provided that the Private Party procures that the Reinstatement Works are carried out and completed in accordance with the contractual arrangements referred to in Clause (bb)above, it shall not exercise any right which it might otherwise have had to terminate this Agreement by virtue of the event which gave rise to the claim for the Relevant Proceeds; and[217]

(ee) after the Reinstatement Plan has been implemented to the reasonable satisfaction of the Institution and in accordance with Clause (d) below, the Institution shall permit withdrawal by the Private Party of any Relevant Proceeds then held in the Joint Insurance Account that have not been paid under Clause (cc) above, in respect of the Relevant Incident, together with any interest accrued.

(d) Where insurance proceeds are to be used, in accordance with this Agreement, to repair, reinstate or replace any Project Asset forming part of the construction Works, the Private Party shall carry out the Reinstatement Works or procure that the work is carried out in accordance with the [construction specification] so

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[217] This would apply if the definition of Relief Events did not cover the insured event giving rise to the issue of reinstatement. If this is the case then the Agreement should confirm that the concepts of Compensation Events and Relief Events will apply during the period of carrying out the Reinstatement Works so that, for example, any Institution Variation (see Part K: *(Changes in Law and Variations)*) will be treated as a Compensation Event (See Part J:46 (*Relief Events),* Part J:47 (*Compensation Events*) and Part J:48 *(Force Majeure.)*) during this period.

that on completion of the Reinstatement Works, the provisions of the Agreement are complied with.

44.1.2 Economic Test

44.1.2.1 The Private Party should always be obliged to reinstate the damaged Project Assets and the Services if an insured event occurs.[218] If the Institution does not require reinstatement, then any insurance proceeds should go to the Private Party but the Institution should be aware that this effectively results in a termination for convenience. As such, the Institution will be obliged to make a full payout to the Private Party (see Part N:64 *Compensation: Termination for Convenience*), but deducting such amounts from the payment.

44.1.2.2 In some PPP projects, the Lenders will want to impose an "economic test" to determine whether reinstatement will enable them to recover the Debt in full. If the economic test shows that this is not possible, then the Lenders will prefer to appropriate the insurance proceeds to service the Debt instead of allowing reinstatement.[219]

44.1.2.3 Resort to an "economic test" is, however, not always necessary. An economic test should not be necessary where there is a low risk of total destruction of the asset (such as with a road project or a project that has a large number of geographically diverse sites) and a lengthy reinstatement period.

44.1.2.4 Where a high risk exists, however, the Institution may have to accept an economic test based on a loan life cover ratio[220] so that

[218] It is standard in the insurance industry for the insured amount in relation to fixed assets to cover their full replacement value as opposed to their market value.

[219] The Lenders will usually be co-insureds under all the Project insurances, required and discretionary.

[220] If this is being calculated during the Service Period and no further drawdowns are possible, then this is calculated by *dividing*: (a) forecast net revenues until the final maturity date of the Debt (including Unitary Payments and the proceeds of business interruption insurance), discounting back future revenues to the date of calculation (at the interest rate payable under the Debt) and assuming that the damaged Project Assets have been reinstated; by (b) the Debt outstanding less all credit balances, each as at the date of calculation. If further drawdowns can be made, then this calculation should take into account actual drawdowns plus all undrawn commitments to the extent forecast in the Financial Model.

the Lenders cannot abandon the Project if the test shows that debt service is achievable (even if there is hardly any cushion above the ratio). The use of an annual debt service cover ratio as an economic test is incorrect as this ratio contains only an annual "snapshot" of performance, which is not relevant. There should be no need to specify a threshold amount of insurance proceeds below which the economic test should not be applied because the test should, in any event, only be applied in cases of total or near total destruction.

44.1.2.5 If the economic test shows that the full Debt can still be recovered from the Project even if the damaged Project Assets are reinstated, then the Private Party must be obliged to reinstate the Project Assets in accordance with a pre-agreed reinstatement procedure. If the economic test shows that the full Debt cannot be recovered as aforesaid thereby allowing the Lenders to take the insurance proceeds or an amount equal to the outstanding Debt (whichever is the lesser) in discharge of the Debt, the Private Party must nevertheless remain under an obligation (to the Institution) to reinstate the asset. If, as is likely, the Private Party is not financially able to do so, then it will be in breach of the Agreement and the Institution will terminate for Private Party Default in the usual way (see Part N: *(Termination)*). The Institution can then rebuild the asset through a new tender.

Standard Clause

Economic Test

(a) If all or substantially all of the Project Assets are destroyed or substantially destroyed in a single event and the insurance proceeds (when taken together with any other funds available to the Private Party)[221] *are equal to or greater than the amount required to repair or reinstate the Assets, then the Private Party*[222] *shall calculate*[223] *the [loan life cover ratio] (on the assumption that the Assets are repaired or reinstated in accordance with this Agreement).*

(b) If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is greater than or equal to the [event of default level],[224] *then the Private Party shall be subject to the reinstatement procedure set out in Clause [x] (Insurance: Reinstatement).*

(c) If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is less than the [event of default level], then an amount equal to the lesser of:

(i) the insurance proceeds; and

(ii) the Debt,[225]

shall be released from the Joint Insurance Account to the Private Party and such release shall constitute a complete discharge of all and any liability on the part of the Institution in respect of the insured event and the destroyed Project Assets, but shall not discharge the Private Party from performing the Project Deliverables in accordance with the Agreement.[226]

[221] Such funds could, for example, include sums made available to the Private Party by the Institution to ensure that the test is passed and that, as a result, reinstatement occurs in accordance with this Part I:44.1.1 *(Insurance: Reinstatement)*.

[222] The calculation will be controlled by the Lenders in the Financing Agreements. Checks will need to be made by the Institution that this calculation allows reinstatement.

[223] There will be a debate as to how this should be done. Since the Lenders' interests are being protected here, the formulae set out in the Lenders' financial model provided for in the Financing Agreements should be used.

[224] That is the loan life coverage ratio as provided in the Financing Agreements below which an event of default will be triggered under the Financing Agreements entitling the Lenders to accelerate the Debt.

[225] Excluded from this will be amounts standing to the credit of the Joint Insurance Account.

[226] This will mean the amounts are released to the accounts secured to Lenders and the Lenders will apply such amounts as a prepayment against Debt.

44.2 **Other Required Insurance**

44.2.1 In the case of any legal liability insurance, the Private Party should be obliged to apply the proceeds of any claim made under such insurance either in satisfaction of the liability in respect of which such claim is made or to reimburse the Private Party to the extent that the liability has already been paid by it out of other Project revenues.

44.2.2 The Private Party should be obliged to apply the proceeds of any business interruption insurance in service of the Debt and the balance in payment of any expenditure incurred by the Private Party in performing Project Deliverables. The Agreement should prohibit the Private Party from applying any such proceeds in repayment or payment of Shareholder Loans or to cover any return on Equity.

PART J: RELIEF EVENTS, COMPENSATION EVENTS AND FORCE MAJEURE

45 INTRODUCTION

45.1 The Private Party usually undertakes to ensure Service Commencement by a particular fixed date[227] and to continue to provide the Services for the duration of the Agreement. There may, however, be events, which result in the Private Party, through no fault on its part, being unable to meet this obligation. In these circumstances, the Private Party should be excused from liability for failure to commence or provide the Services. A balance must, however, be attained between encouraging the Private Party to manage the risk and protecting the Institution from non-performance.

45.2 **These events can be divided into three broad categories:**

45.2.1 Relief Events: These are events which may arise at any stage during the Project Term which are best managed by the Private Party (although not necessarily in its control) and for which the Private Party bears the financial risk, but in respect of which no rights of termination should arise (see Part J:46 (*Relief Events*)).

45.2.2 Compensation Events: These are events that are clearly at the Institution's risk and in respect of which the Private Party should be compensated (see Part J:47 (*Compensation Events*)).

45.2.3 Force Majeure Events: These are a limited set of events which may arise during the life of the Agreement through no fault of either Party, which are best managed by the Private Party (although not in its control) and in respect of which rights of termination can arise (see Part N:66 (*Compensation: Termination for Force Majeure*)).

45.3 The distinction between Relief Events and Compensation Events (at least during the construction phase) is sometimes expressed as being the difference

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[227] The typical structure in PPP projects is to require the Private Party to ensure Service Commencement either by the scheduled date for the completion of construction or at any time from the Signature Date of the Agreement, but by the Long Stop Date (see Part E: (*Duration and Service Commencement*)).

between the Private Party being given 'time' only and 'time and money'. Force Majeure is, however, a different category of event and is dealt with alongside other termination-related issues (see Part N:66 (*Compensation: Termination for Force Majeure*)).

45.4 Certain of these events may be dealt with differently depending on the nature of the Project, the likelihood of the event occurring and the value for money obtained if the Private Party prices into its bid the risk of such event occurring. Given that Compensation Events result in the Institution paying money to the Private Party, this should only be incorporated after careful consideration of the specifics of each case. For example, in a Project in which Responsible Authority use of the Project Site during the construction phase means that there is a high risk of delays occurring during the construction phase, the Institution may accept that these delays should be Compensation Events. In a Project where such risks do not exist, the Parties may agree that a Relief Event is the most appropriate way to deal with that risk. The risk of discovery of fossils or antiquities during the construction phase, which lies somewhere between the Compensation Event and Relief Event approach, may be dealt with as resulting in a Relief Event (as is suggested in Part D:15 (*Heritage Resources)*. Alternatively, it may be dealt with by agreeing that the Private Party will bear a pre-determined initial level of loss (both financial and in terms of delays to the Works programme) with further losses above that prescribed level being shared by the Parties in accordance with an agreed formula.[228]

45.5 Similarly, the risk of planning delays may require different treatment in different Projects. For example, the Institution may accept some planning delay risk in order to obtain value for money if it wants the Agreement to be signed before full detailed planning consent is obtained. As far as the discovery of adverse ground conditions and historic contamination is concerned, this should not usually be at the Institution's risk as the Private

[228] This alternative approach may be applied in a wide range of projects, but should ordinarily only be used when dealing with the risk of discovery of fossils or antiquities and not other risks. A different approach is justified here because of the potential impact of such risk being greater than is the case with other possible Relief Events because of the public benefit derived from the discovery of fossils and antiquities.

Party should have carried out appropriate surveys in relation to such matters prior to signing the Agreement and can often assess and accept such risks more economically than the Institution is able to do. The situation may be different in specific circumstances such as where the Private Party has been prevented from carrying out appropriate surveys or it is not reasonable or good value for money for surveys to be undertaken (for example, because of the number of sites involved in the Project).[229]

46 RELIEF EVENTS

46.1 Purpose and Scope

46.1.1 Relief Events are events which prevent performance by the Private Party of its obligations at any time, in respect of which the Private Party bears the financial risk in terms of increased costs and reduced revenue but for which it is given relief from termination for failure to provide the full Services. The events listed in the standard definition below may be outside the Private Party's control, but that is not the only appropriate measure of whether an event should appear on the list since many events beyond the Private Party's control at the time they occur could in fact have been prevented by proper precautions (for example, fire). Relief Events should cover those events, the risk of which is better borne by the Private Party as it is in a better position than the Institution to mitigate and manage the consequences. This mitigation and management could be in the form of insurance, a combination of insurance and proper planning, or by risk management and planning (that is, the events can be worked around while they exist).

46.1.2 Termination should not follow a Relief Event. This is because any replacement Private Party would be similarly affected and so the Institution's position would not be improved by termination. Relief Events do not, however, require the same treatment as Force Majeure events (see Part N:66 (*Compensation: Termination for Force Majeure*))

[229] See Part C:7 (Warranties and Representations) and Part D (Project Site).

as their consequences are not likely to be as severe and will usually only last for a finite period.

46.1.3 It may be argued that a right to terminate should exist if a Relief Event continues for a prolonged period. Other than in certain critical projects[230] or in the case of the discovery of any unforeseen heritage object[231] this is not recommended for two reasons. First, because this may not sufficiently incentivise the Private Party to manage the risk (depending on any compensation payable on termination) and second, because the occurrence of such an event is likely to be of a limited duration (for example, strikes by a supplier) and/or lead to an alternative sourcing of the supply concerned by the Private Party (for example, any shortage of fuel).

Standard Definition

"Relief Event" *means*:[232]

(a) *fire, explosion, tempest, flood, ionising radiation (to the extent it does not constitute an event of Force Majeure), earthquakes, riot and civil commotion, or pressure waves caused by devices travelling at supersonic speed;*

(b) *(without limiting the obligations of the Private Party regarding service level specifications) failure by any Responsible Authority, utility or other like body to carry out works or provide services;*

(c) *accidental loss or damage to the Works and/or Facilities;*

(d) *failure or shortage of power, fuel or transport;*

(e) *blockade or embargo which does not constitute an event of Force Majeure;*

(f) *the discovery of any heritage objects or resources or Project Site Conditions that could not reasonably have been discovered by*

230 In the interests of certainty in particular projects, for example where the Services are needed for a hospital, a right to terminate should exist for both Parties in the event of prolonged occurrence of a Relief Event.

231 It is recommended that should these result in a prolonged delay, the Parties should meet in order to ascertain the best way of continuing with the project, given the circumstances.

232 This list can be modified for specific sectors (for example, the unintentional introduction of a virus in an IT project) provided that the commercial risk of the occurrence of such events is still with the Private Party. There will also be circumstances in which the uninsurability of particular risks may constitute a Relief Event and prevent either Party from terminating the Agreement (see Part I:42 (*Risks that Become Uninsurable*)).

proper due diligence as contemplated in Clause [x] (Project Site Conditions);[233] *or*

(g) any official or unofficial strike, lockout, go slow or other such labour disputes generally affecting the [   ] industry[234] *or a significant sector of it,*

unless any of the events listed in Clauses (a) to (f) inclusive arises (directly or indirectly) as a result of any negligence, wilful act or default of the Private Party or any Subcontractor.

46.1.4 Consequences

46.1.4.1 The financial effects of delays caused by Relief Events are borne by the Private Party. As such, when these delays occur the Institution should pay no compensation. If a Relief Event occurs prior to Service Commencement, any Long Stop Date will be extended by a period equal to the relevant delay. In most cases the only relief given will be relief from termination.

46.1.4.2 There should be no extension to the Project Term due to a Relief Event as such extension poses an unacceptable degree of risk for the Institution. This is because if an extension were given, then although the Private Party does not receive the Unitary Payment during a Relief Event (save to the extent the Service is delivered),[235] the Private Party's revenue period would be kept whole. If an extension is given then there may be a reduced incentive on the Private Party to manage the effects of the Relief Event and restore the Services as soon as possible. In addition, the Institution's exposure to any risk it bears under the Agreement is extended indefinitely as the Expiry Date may be continually extended. By extending the Agreement, therefore, the Institution could be taking a substantial element of the risk of the occurrence of Relief Events.

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233 See Part D:14 (*Project Site: Environmental Risks) and* Part D:15 (*Project Site: Heritage Resources)*.

234 This will be the principal industry relating to the PPP project concerned. For example, in an accommodation project, this will include the building maintenance or facilities management industries.

235 This must be read in conjunction with Part H: (*Payment and Financial Matters)*.

46.1.4.3 The Parties should consider, on a project-by-project basis, whether or not the Private Party should be relieved of any liability for liquidated damages or penalties, although Penalty Deductions should continue to be made where necessary in respect of the period of delay caused by the Relief Event (see Part E:21 (*Security against late Service Commencement*) and Part H: (*Payment and Financial Matters))*. Liquidated damages or penalties prior to Service Commencement (to the extent they exist) are designed to compensate the Institution for specific losses due to late delivery of the Services so that if the Private Party fails to commence provision of the Services due to a Relief Event, the Institution will still suffer this loss.[236] Depending on the nature of the Project however, the Institution may feel that it will obtain better value for money if it allows the Private Party relief from liquidated damages or penalties during a Relief Event.

46.1.4.4 When a Relief Event has occurred and the Institution has been informed, the Parties should consult on relevant issues, such as the likely duration of the Relief Event and the action to be taken to mitigate its effects. In the event of the discovery of any unforeseen heritage object or resources that result in a prolonged delay it may be necessary to provide for a mechanism by which the Parties can meet in order to find a solution that attempts to salvage the Project while being mindful of the impact of such prolonged Relief Event on the Private Party and the Project.

46.1.4.5 The Institution should not normally expect to exercise any step-in rights which it has during a Relief Event (see Part O: (*Step-In*)). If the Private Party is not using reasonable endeavours to remedy matters and mitigate the consequences, it will not obtain the relief afforded by Relief Events (which should always be subject to the

[236] In most cases the extension of time allowed to the Private Party will mean that its construction completion or Service Commencement Dates will be moved to later dates, so that it will not be in default of its Service obligations and the question of liquidated damages or penalties will not arise.

Private Party's obligation to mitigate) and will be at risk of termination for Private Party Default. This should provide a sufficient incentive for the Private Party to perform (depending, in part, on the approach taken to relief from other obligations under the Agreement).[237]

Standard Clause

Consequences of a Relief Event

(a) *If and to the extent that a Relief Event:*

(i) *directly causes a delay in Service Commencement; and/ or*

(ii) *materially adversely affects the ability of the Private Party to perform any of its obligations under this Agreement,*

then the Private Party shall be entitled to apply for relief from any rights of the Institution arising under Clause [x] (Termination for Private Party Default) [and its obligations[238] *under this Agreement].*

(b) *To obtain relief, the Private Party must:*[239]

(i) *as soon as practicable, and in any event within [x] days after it became aware that the Relief Event has caused or is likely to cause delay and/or materially adversely affect the ability of the Private Party to perform its other obligations, give to the Institution a notice of its claim for relief from its obligations under the Agreement, including full details of the nature of the Relief Event, the date of occurrence and its likely duration;*

(ii) *within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details of the relief claimed; and*

(iii) *demonstrate to the reasonable satisfaction of the Institution that:*

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237 How long "prolonged" is will depend on the particular project. It should in any event not be less than six months.

238 Generally, Relief Events should give only relief from the risk of termination for failure to complete or failure to perform. In cases in which liquidated damages are payable to the Institution there will be an issue of the extent to which relief can be given from claims for damages or liquidated damages. The performance regime should still apply and this should be made clear, to the extent that there is potential for relief from liquidated and other damages.

239 The approach here is to set out a quick procedure so that relief can be given or refused on a sensible timescale without additional delays.

(A) *the Private Party and its Subcontractors could not have avoided such occurrence or consequences by steps which they might reasonably be expected to have taken, without incurring material expenditure;*

(B) *the Relief Event directly caused the delay to the Scheduled Completion Date [or the need for relief from other obligations under the Agreement];*

(C) *the time lost and/or relief from the obligations under the Agreement claimed could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice, without incurring material expenditure; and*

(D) *the Private Party is using reasonable endeavours to perform its obligations under the Agreement.*

(c) *In the event that the Private Party has complied with its obligations under Clause (b) above, then:*

(i) *the Scheduled Completion Date shall be postponed by such time as shall be reasonable for such a Relief Event, taking into account the likely effect of delay; and/or*

(ii) *the Institution shall not be entitled to exercise its rights to terminate the Agreement under Clause [x] (Termination for Private Party Default) [and, subject to Clause (d) below, shall give such other relief as has been requested by the Private Party].*

(d) *[Nothing in Clause (c) above shall affect any entitlement to make Penalty Deductions*[240] *or any deductions made as a result of [Part H (Payment and Financial Matters)] during the period in which the Relief Event is subsisting].*

(e) *In the event that information required by Clause (b) above is provided after the dates referred to in that Clause, then the Private Party shall not be entitled to any relief during the period for which the information is delayed.*

(f) *The Private Party shall notify the Institution if at any time it receives or becomes aware of any further information relating to the Relief Event, giving details of that information to the extent that such information is new or renders information previously submitted materially inaccurate or misleading.*

[240] If the termination levels under the Agreement for non-performance are connected to Penalty Deductions made under the Agreement or the award of Penalty Points, the Agreement should ensure that Penalty Points and/or Penalty Deductions due to non-performance caused by Relief Events are not taken into account in the termination provisions of the Agreement.

(g) *In the event of a Relief Event stipulated in Clause [x][241] that continues for a period in excess of [x][242] the Parties shall meet in order to find a mutually satisfactory solution for dealing with such prolonged Relief Event.*

(h) *If the Parties cannot agree the extent of the relief required, or the Institution disagrees that a Relief Event has occurred or that the Private Party is entitled to any [extension of the Scheduled Completion Date and/or relief from other obligations under this Agreement], the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).*

47 COMPENSATION EVENTS

47.1 Purpose and Scope

47.1.1 Compensation Events are designed to cater for delays which arise before the Service Commencement Date and are at the Institution's risk and which result in a delay to Service Commencement and/or increased costs to the Private Party, although the concept may be extended to the Service Period. Such events are more appropriately dealt with by compensating the Private Party as opposed to constituting Institution Default. In fact, even a delay is not strictly necessary for the occurrence of a Compensation Event as cost increases can arise without any timetable changes.

47.1.2 Events which can arise before the Service Commencement Date and for which the Institution should compensate the Private Party are:

47.1.2.1 Institution breach of an obligation (which includes a breach occasioned by third parties for whom the Institution is responsible, such as teachers or doctors);

47.1.2.2 Institution Variations (see Part K:50 (*Variations*)); and

47.1.2.3 Relevant Changes in Law (see Part K:49 (*Changes in Law*)).

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[241] The discovery of any unforeseen heritage objects or resources.

[242] This will depend on the specific project. A period (usually not longer than 180 days) must, however, be inserted.

47.1.3 The Institution should bear the effects of Institution Variations and Relevant Changes in Law in accordance with Part K *(Changes in Law and Variations)*. The only significant difference in relation to how these events are dealt with during the Service Period is referred to in Section 47.3 *(Calculation of Compensation)*. As mentioned in Part J: (*Relief Events, Compensation Events and Force Majeure*), it may, after careful consideration in certain projects, be appropriate to add other (or sector) specific events. As Variations and Relevant Changes in Law are dealt with in Part K (*Changes in Law and Variation)*, the definition for Compensation Events should not include these.

Standard Definition

*"**Compensation Event**" means any breach[243] by the Institution of any of its obligations under this Agreement,[244] to the extent in each case that the breach is not caused or contributed to by the Private Party or any of its Subcontractors.*

47.1.3.1 The Institution should bear the risk of any Relevant Change in Law that occurs during the Service Period in accordance with the principles set out in Part K:49 (*Changes in Law*). The only significant difference between Relevant Changes in Law and Variations is in relation to the calculation of compensation.

47.1.3.2 The Institution may be faced with a request by the Private Party and its funders to pay compensation for Institution breaches which occur during the Service Period. This will not always be appropriate and the Institution should carefully consider the nature of its obligations during the Service Period. If its sole obligation is to make payment, then there is no need to pay compensation as non-payment in the Service Period is addressed through the provisions dealing with interest on late payment (see Part H: (*Payment and Financial Matters)*) and, in extreme cases, through

[243] This is a breach that will not normally constitute Institution Default (which can lead to termination – see Part N:62 (*Compensation: Termination for Institution Default*)), but which will nevertheless cause delay and have substantial cost implications for the Private Party, including, for example, a failure to allow the Private Party appropriate access to the Project Site.

[244] To the extent that the Institution is contracting on behalf of others, these should be included.

termination for Institution Default (see Part N: (*Compensation; Termination for Institution Default*)). During an insurance reinstatement, however, the concept of Compensation Events would apply irrespective of the position for the treatment of Compensation Events in the Service Period, as the construction phase will effectively be starting again until reinstatement is completed. The issues relating to reinstatement are dealt with in depth in Part I: (*Insurance*).

47.1.3.3 If, however, the Institution has significant ongoing obligations and breach of such obligations would materially and adversely affect the Private Party's ability to perform (for example, if the Institution failed to carry out procedures for certifying operating matters) or materially affect the cost of performance, then it may be appropriate to give compensation if such breach occurs. This can most easily be addressed by extending the scope of the Compensation Event concept.

47.2 **Consequences**

47.2.1 The practical consequence of a Compensation Event occurring during the Works phase is that the Service Commencement Date will need to be postponed, usually by the length of any delay caused (any Long Stop Date will similarly be extended). This means that the start date of the Private Party's revenue stream is also delayed and/or additional costs incurred (subject to the Private Party's obligation to mitigate). A Compensation Event, which occurs after Service Commencement, may result in the Private Party's revenue stream being reduced or interrupted and/or additional costs being incurred. As a result, the Private Party may incur finance charges and additional costs which could involve the Private Party in significant expense.

47.2.2 The Parties must agree how to compensate the Private Party for any delay in Service Commencement or reduction or interruption of its revenue stream or additional costs incurred by it which result directly from a

Compensation Event. The prescribed approach is to retain the original Expiry Date and compensate the Private Party for its loss. This does not mean that payment of the Unitary Payment[245] is to be made for a month in respect of which no Services have been provided although the monetary value of the compensation may be the same as the Unitary Payment.

47.2.3 If the Agreement contains liquidated damages or penalty provisions (see Part E:21 (*Security against late Service Commencement*)), then the Private Party will also be relieved from liability for liquidated damages or penalties for the period of delay caused by the Compensation Event. The Private Party should, of course, also be relieved of any other liability for the Institution's losses in respect of the Compensation Event. This should be taken into account in determining the consequences for the Institution of a Compensation Event.

47.2.4 The main advantages of the prescribed approach are firstly, simplicity and secondly, that funders should prefer it, since the debt cover ratios and internal rate of return on Equity can be preserved. This approach also means that the Institution has an incentive to manage its rights and obligations in the construction phase in a way that does not result in delay. The detail of how this approach should work in practice can be seen with reference to Part J:47.3 (*Calculation of Compensation)*, below.

47.2.5 If the Private Party is fully compensated for the delay, there is no need to extend the Expiry Date.

47.2.6 The Private Party must use reasonable endeavours to mitigate its losses and costs (for example, by rescheduling its Works programme or by redeploying staff). Such mitigation may result in there being no delay in the Service Commencement Date (although extra costs may result from the steps taken to mitigate).

[245] This happens automatically in circumstances where the Private Party's revenue is derived from user charges as in the case of toll roads, where the charge may only be levied when the Services have been rendered.

47.3 **Calculation of Compensation**[246]

47.3.1 The Unitary Payment may need to be adjusted if the Compensation Event concerned involves additional cost[247] or a time delay which has cost and/or loss of revenue implications. It is important that the Agreement contains an appropriate method for dealing with any payment variations that arise as a result of a Compensation Event. Any agreement reached in respect of the value of the compensation payable should be final and not subject to change if it later transpires that the costs associated with such Compensation Event are greater (or less than) the amount agreed to. This is equally applicable to costs arising as a result of Variations and/or Changes in Law (see Part K: (*Changes in Law and Variations*)).

47.3.2 One common way of dealing with such events is to rely on the Financial Model to deal with the issue and for both Parties to use this to calculate how and when compensation should be paid. Typically this would require the Institution to agree that the debt cover ratios and internal rate of return on equity remain unchanged. While there is no objection in principle to the Parties referring to a Financial Model to calculate compensation payable for Compensation Events (and for that matter the effects of an Institution Variation or Relevant Changes in Law (see Part K: (*Changes in Law and Variations*)) provided both Parties fully understand all of the Financial Model's various aspects, there are several principal problems that can arise in using a Financial Model:

47.3.2.1 the Financial Model may obscure the process being followed in reaching the answer, unless there is clarity on all sides on how the relevant formulae used in the model work. For example, if something has happened which was not originally modelled for and audited, there could be conflict arising on how to model it, which could impact on the calculation concerned;

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[246] Payment of any compensation will be subject to the regulations regarding budgets (see Part H:37 (*Unitary Payments*)).

[247] In terms of the Treasury Regulations, material amendments or amendments that change the risk profile or value for money considerations require the approval of National Treasury. The Institution must ensure, at the relevant time, that it obtains the requisite approvals.

47.3.2.2 if the Institution has access to the Financial Model in sufficient detail and to all of the internal costs, returns and other assumptions (to the level of detail required), then more information than is relevant simply to value the consequences of the event may have to be provided by the Private Party, which may not be acceptable to it (and, in addition, certain of the assumptions may need to be updated); and

47.3.2.3 the result of preserving the ratios and internal rate of return on Equity can be achieved in a number of different ways (see Part J: 47.3.5).

A simple approach is recommended since the aim of this section is to ensure fair compensation for a limited number of events calculable in a relatively straightforward manner. If the Unitary Payment is to change, then financial advice is likely to become necessary.

47.3.3 The prescribed approach to Compensation Events that may lead to a change in the Unitary Payment is as follows:

47.3.3.1 if the event concerned requires Capital Expenditure (whether before or during the Service Period), then in most cases, it will be more practicable to deal with this by means of a lump-sum reimbursement (subject to the possibility of interim payments[248]); and

47.3.3.2 if the event concerned requires a change in operating costs, then an adjustment in the Unitary Payment is the appropriate means of payment.

In the event of an Institution breach it is also acceptable for the Institution simply to reimburse the Private Party on the basis of actual

[248] Significant Institution Variations are likely to be acceptable to the Private Party only if compensation is paid by the Institution so as to match the timing of the agreed costs of the Variation.

costs incurred (for example, as a result of any delay in giving an approval).[249]

47.3.4 The approach of a lump-sum reimbursement and/or adjustment of the Unitary Payment ensures that a minimum of additional financing costs is incurred. Other reasons, including affordability constraints, may, however, mean that the Institution wishes to reserve the right to ask the Private Party to use reasonable endeavours to finance the event where Capital Expenditure is required. If this is done, then careful scrutiny of the value for money implications should be undertaken.

47.3.5 Where the compensation involves an increased obligation to incur Capital Expenditure, other possibilities[250] include:

47.3.5.1 a lump-sum payment from the Institution paid immediately on Service Commencement. The amount of the lump-sum should exceed the amount of the relevant increase in Capital Expenditure by any incremental increase in financing costs as a result of a more frequent drawdown of Debt than originally anticipated and the agreed costs incurred in arranging any such financing;

47.3.5.2 an adjustment to the Unitary Payment to take account of the Private Party's increased debt service obligations as a result of funding the event concerned. This adjustment would be appropriate to the actual terms and conditions of the funding, which would have been known to and approved by the Institution, and be applied on the basis that the funders are no worse and no better off, from the perspective of risk and return, than they would have been had the increase in Capital Expenditure not arisen. As stated above, in practice this generally means that an increase is

[249] Where there is no Unitary Payment but the Private Party is compensated from user charges, an adjustment of the user charges is problematic because the setting of tariffs is a regulatory function that cannot be fettered and that may not be delegated to a Private Party. Also, as these user charges are often paid directly by the public, adjustments in user charges run the risk of public protestor action. Adjusting user charges may therefore not be feasible and any payment to the Private Party as a result of, for example, a change in operating costs, may have to be made by way of a payment by the Institution.

[250] Particularly to avoid the time and expense of engaging advisers for what may be minor compensation sums (if this approach is used), it is recommended that the Parties agree and record in the Agreement the incremental impact on the Unitary Payment of minor Capital Expenditure and operational expenditure changes.

made to the Unitary Payment (over the term of amortisation of the additional dedicated funding) to restore the debt cover ratios and the return on Equity to their values had the additional funding not been required. This calculation can only be made by using the Financial Model. This approach can be problematic. The Institution should not seek a grace period on paying a higher Unitary Payment even if this would satisfy the debt cover ratios and return on Equity (as this could cause inappropriate distortion to the cash flow profile); or

47.3.5.3 particularly if the Institution cannot afford to pay compensation in the form of a lump-sum but wishes to avoid having to use the Financial Model, it may offer to pay a supplementary Unitary Payment over a stipulated period in the form of an annuity equivalent of the Capital Expenditure. If this approach is adopted, the discussion can be reduced to a single issue, namely, the annuity rate to be applied. In this case, the Institution need not be concerned with how and at what cost the Private Party has arranged additional dedicated funding, if any.[251]

47.3.6 If the event concerned involves a Capital Expenditure reduction (for example, cancellation of a wing of a building), this would involve a reduction in Unitary Payment. The size of reduction will depend not only upon the savings in Capital Expenditure but also upon consequent savings in finance and operating costs. The decision on whether or not to cancel any excess committed financing (if this is possible in terms of the financing structure concerned) will be taken jointly with the Private Party and its funders. The concept of a lump-sum payment (or refund), whether single or in instalments, does not arise as a possibility in this context. There are two alternative approaches to determining the appropriate reduction in Unitary Payment: either to use the Financial

[251] If the original Unitary Payment over the chosen annuity payment period is profiled, then the supplementary Unitary Payment should similarly be profiled. Annuities based upon nominal discount rates would be excluded from any indexation provisions of the Unitary Payment.

Model or to determine the annuity equivalent reduction. With an annuity equivalent reduction, the term of the annuity should be the term of the Agreement unless the Parties agree otherwise.

47.3.7 If the compensation arises only because of a change in operating costs then appropriate changes to the Unitary Payment should be by negotiation and may be possible without reference to the Financial Model even where the impact on operating costs is periodic or irregular over time. The change in the Unitary Payment should be made at the time of the Compensation Event so as to reflect forecast operating costs changes, as to amount and timing. The use of lump-sum compensation payments or annuity equivalents is also inappropriate for changes in operating costs. As many of the above issues have complicated financial consequences, financial advisers should be consulted as to the most appropriate approach for a particular project.

47.3.8 In any event (even if this approach is taken in relation to Variations and Relevant Changes in Law), it is not appropriate in any circumstances for a breach by the Institution of its obligations to give rise to an obligation on the Private Party to finance any Capital Expenditure consequences.[252]

47.3.9 In assessing the consequences of a Compensation Event, other causes of delays to the Service Commencement Date will be relevant as to whether the Private Party will receive relief from its obligations and/or compensation. The Private Party's losses should be calculated as accurately as possible at the time, and appropriate payment made.

Standard Clause

<u>*Delays in Service Commencement due to a Compensation Event*</u>

(a) If, on or before the Service Commencement Date,[253] as a direct result of the occurrence of a Compensation Event:[254]

[252] See Part K: (*Changes in Law and Variations*).

[253] This provision will also apply during the work of a construction nature (such as on an insurance reinstatement following total or partial destruction of an asset). The concept can also be extended in respect of an Institution obligation to be performed during the Service Period, particularly if there are non-payment obligations on the Institution. Subject to the reinstatement point,

(i) the Private Party is unable to achieve Service Commencement on or before the scheduled Service Commencement Date;

(ii) the Private Party is unable to comply with its obligations under this Agreement; and/or

(iii) the Private Party incurs costs or loses revenue,[255]

then the Private Party is entitled to apply for relief from its obligations and/or claim compensation under this Agreement.

(b) To obtain relief and/or claim compensation the Private Party must:

(i) as soon as practicable, and in any event within [x] days after it became aware that the Compensation Event has caused or is likely to cause delay, breach of an obligation under this Agreement and/or the Private Party to incur costs or lose revenue, give to the Institution a notice of its claim for an extension of time for Service Commencement, payment of compensation and/or relief from its obligations under this Agreement;

(ii) within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details[256] *of the Compensation Event and the extension of time and/or any estimated change in project costs claimed;*[257] *and*

(iii) demonstrate to the reasonable satisfaction of the Institution that:

(A) the Compensation Event was the direct cause of the estimated change in project costs and/or any delay in the achievement of the scheduled Service Commencement Date; and

(B) the estimated change in project costs, time lost, and/or relief from the obligations under the Agreement claimed, could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice.

(c) In the event that the Private Party has complied with its obligations under Clause (b) above, then:

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however, the principal obligations in the Service Period will be payment related and can often be dealt with through provisions dealing with interest on late payment. See Part H: (*Payment and Financial Matters)*.

254 In the event of a delay to the Scheduled Completion Date, the construction costs will most likely increase due to a longer financing period. The Private Party is under a duty to mitigate its other costs associated with any delay (for example, by delaying recruitment, if this can be done).

255 This loss means not only out-of-pocket costs but also a claim for loss of profits (including a lost completion bonus), if any, caused directly by the Compensation Event.

256 The Institution and the Private Party may wish to specify in the Agreement precisely what details are required.

257 This figure will not calculate the compensation payable, but it gives an indication of the seriousness of the breach and so indicates what steps should be taken by way of mitigation.

(i) the Scheduled Service Commencement Date shall be postponed by such time as shall be reasonable for such a Compensation Event, taking into account the likely effect of delay;[258]

(ii) in the case of an additional cost being incurred by the Private Party:

(A) on or before the Service Commencement Date; or

(B) as a result of Capital Expenditure being incurred by the Private Party at any time,

the Institution shall compensate the Private Party for the actual estimated change in project costs as adjusted to reflect the actual costs reasonably incurred within [x] days of its receipt of a written demand by the Private Party supported by all relevant information;[259]

(iii) in the case of a payment of compensation for the estimated change in project costs that does not result in Capital Expenditure being incurred by the Private Party but which reflects a change in the costs being incurred by the Private Party after the Service Commencement Date, the Institution shall compensate the Private Party in accordance with Clause (f) below by an adjustment to the Unitary Payment; and /or

(iv) the Institution shall give the Private Party such relief from its obligations under this Agreement, as is reasonable for such a Compensation Event.

(d) In the event that information is provided after the dates referred to in Clause (b) above, then the Private Party shall not be entitled to any extension of time, compensation, or relief from its obligations under this Agreement in respect of the period for which the information is delayed.

(e) If the Parties cannot agree the extent of any compensation, delay incurred, relief from the Private Party's obligations under the Agreement, or the Institution disagrees that a Compensation Event has occurred (or as to its consequences), or that the Private Party is entitled to any relief under this Clause, the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).

258 This is only necessary if there is a Long Stop Date. If the Private Party is required to pay the Institution liquidated damages for failure to achieve Service Commencement by the scheduled Service Commencement Date, the Institution should consider how the Private Party's obligation to pay will be relieved if a Compensation Event occurs after the scheduled Service Commencement Date but prior to actual Service Commencement.

259 This payment can be in the form of monthly payments as expenditure is incurred (or staged payments against milestones) and invoiced if the delay is for a significant period of time.

(f) Any payment of compensation referred to in Section (c) (iii) above shall be calculated in accordance with [Clause [x] (Calculation of Compensation) above].[260]

48 FORCE MAJEURE

48.1 Introduction

48.1.1 Relief Events include several events, which have often been included in the definition of Force Majeure. As the remedies available under Relief Events deal adequately with the consequences of such events, there is no need for the all-encompassing definition of Force Majeure that has been common in many contracts concluded to date. Force Majeure should be defined to include those very limited events which are out of the control of both Parties and which, if they continue for a certain period of time,[261] can result in termination of the Agreement. Force Majeure should only include those events that are likely to have a material adverse consequence on either Party's[262] ability to fulfil its obligations under the Agreement and which are uninsurable. As events of Force Majeure are usually highly unlikely events that are beyond the control of both Parties with neither Party being in any better position to bear such risk, the consequences of an event of Force Majeure should be shared between the Parties.

48.1.2 The Party claiming the occurrence of an event of Force Majeure is only excused from performance to the extent that it is unable to comply with all or a material portion of its obligations under the Agreement. Either Party may terminate the Agreement as a result of an event of Force Majeure, only if the Parties are unable, within the specified period, to agree on how best to continue the Project in light of the Force Majeure event (See Part N:66 (*Termination: Compensation for Force Majeure*)).

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[260] The Institution should not agree to a provision whereby, after the relevant effects of the Compensation Event have been calculated, there is an adjustment of the compensation if the costs are greater or lesser than those agreed or estimated.

[261] Usually six months, but may vary depending on the particular project.

[262] Usually the Private Party's.

48.1.3 For so long as the event of Force Majeure continues, the Institution is only liable to pay the Private Party for Services actually delivered by the Private Party. Any payment by the Institution should take into account any reduction in the Private Party's operating costs due to the Force Majeure event preventing substantial performance. The Private Party should not be entitled to any amount simply to ensure that it is in a position to meet its debt service obligations in whole or in part.

48.2 **Consequences of Force Majeure**

48.2.1 When either Party claims the occurrence of an event of Force Majeure, the Parties should meet in order to find a mutually acceptable solution for the continuation of the Project. Such solution should include the following:

48.2.1.1 the reinstatement of the Facilities, although neither Party would be obliged to do this;

48.2.1.2 adjustment of the Service requirements and/or output specifications;

48.2.1.3 amending the payment mechanism; and/or

48.2.1.4 the extension of the Project Term.

48.2.2 The solution will depend on the nature of the event and its effects on the particular Project.

48.2.3 If the Parties cannot agree on a solution within the stipulated period, either Party should be entitled to terminate the Agreement with compensation payable to the Private Party as set out in Part N:62 (*Compensation: Termination for Force Majeure*).

Standard Definitions and Clauses

Force Majeure

*(a) For the purposes of this Agreement, "**Force Majeure**" means any of the following events or circumstances to the extent that they are uninsurable:*

(i) war, civil war, armed conflicts or terrorism; or

(ii) nuclear contamination unless the Private Party and/or any Subcontractor is the source or cause of the contamination; or

(iii) chemical or biological contamination of the Works and/or the Facilities and/or the Project Site from any of the events referred to in Clause (i) above,

which directly causes either Party to be unable to comply with all or a material part of its obligations under this Agreement.

(b) Subject to Clauses (c)(ii) and (iii) the Party claiming relief shall be relieved from liability under this Agreement to the extent that by reason of the Force Majeure event it is not able to perform all or a material part of its obligations under this Agreement.

(c) Where a Party is (or claims to be) affected by an event of Force Majeure:

(i) it shall take all reasonable steps to mitigate the consequences of such an event upon the performance of its obligations under this Agreement, resume performance of its obligations affected by the event of Force Majeure as soon as practicable and use all reasonable endeavours to remedy its failure to perform; and

(ii) it shall not be relieved from liability under this Agreement to the extent that it is not able to perform, or has not in fact performed, its obligations under this Agreement due to its failure to comply with its obligations under sub-Clause (c)(i).

(d) The Party claiming relief shall serve written notice on the other Party within [x][263] Business Days of it becoming aware of the relevant event of Force Majeure. Such initial notice shall give sufficient details to identify the particular event claimed to be an event of Force Majeure.

(e) A subsequent written notice shall be served by the Party claiming relief on the other Party within a further [x] Business Days which shall contain such relevant information relating to the failure to perform (or delay in performing) as is available, including (without limitation) the effect of the event of Force Majeure on the ability of the Party to perform, the action being taken in accordance with Clause (c)(i), the date of the occurrence of the event of Force Majeure and an estimate of the period of time required to overcome it (and/or its effects).

[263] In IT projects "immediate" notice is usually required.

(f) The Party claiming relief shall notify the other as soon as the consequences of the event of Force Majeure have ceased and when performance of its affected obligations can be resumed.

(g) If, following the issue of any notice referred to in Clause (e), the Party claiming relief receives or becomes aware of any further information relating to the event of Force Majeure (and/or any failure to perform), it shall submit such further information to the other Party as soon as reasonably possible.

(h) During the continuance of any event of Force Majeure which occurs on or after the Completion Date the Unitary Payment payable in respect of such period shall be reduced to an amount equivalent to the Unitary Payments payable in respect of those Services actually delivered by the Private Party to the Institution during such period after taking account of the effects of such event of Force Majeure.

(i) If an event of Force Majeure occurs before the Completion Date, the Private Party shall not be entitled to receive any payment in respect of the Unitary Payment.

(j) Subject to Clause [x][264] the Private Party's sole right to payment or otherwise in relation to the occurrence of an event of Force Majeure shall be as provided in this Clause.

(k) The Parties shall endeavour to agree any modifications to this Agreement which may be equitable having regard to the nature of an event or events of Force Majeure. Clause [x] (Fast-track Dispute Resolution) shall not apply to a failure of the Institution and the Private Party to reach agreement pursuant to this sub-Clause.

[264] The Clause providing for compensation on termination for Force Majeure. See Part N:66 (*Compensation: Termination for Force Majeure)*.