NEGOTIATION PLATFORM
for Public-Private Partnerships in Infrastructure Projects

February 15, 2000

TABLE OF CONTENTS

PREFACE

This Negotiation Platform identifies topics related to the negotiation of the main project agreement for a PPP. The Platform itself is not intended to be a self-contained instruction manual, but rather, only one tool in an array of materials to be used by the instructors in conveying to the government representatives selected for training what is important to understand.

The Platform is expected to be supplemented in several ways. First, the instructors are expected to engage in significant personal interaction with the students, fielding questions about and explaining in greater detail the more difficult concepts set forth in the Platform. Second, various visual aids may be used, such as power point presentations or overhead slides. Third, instructors may use excerpts from texts of actual agreements they have negotiated in order to illustrate certain points raised in the Platform. Fourth, the transactional experience of the instructors should provide the students with meaningful real-life examples of what is described in the Platform. Fifth, mock/simulation exercises could provide the students with an opportunity to put into practice what they learn.

As such, the Platform is intended to be different from a treatise or article about PPPs or project financing, more flexible and less comprehensive, more practical and less academic.

Finally, it should be emphasized that the Platform and accompanying training is designed to provide only an introduction to some of the more fundamental issues involved generally in PPPs. Further training with respect to specific types of infrastructure projects or industrial sectors is recommended in connection with representation of the host government's negotiation of a PPP.

NEGOTIATION PLATFORM
for Public-Private Partnerships in Infrastructure Projects

I. Introduction

Governments increasingly rely on the private sector for the financing and development of infrastructure projects, due to shrinking public financial resources and lending by governments and multilateral lenders. The private sector's ability to mobilize resources and enhance efficiency has further stimulated the market for infrastructure projects that are owned and operated by the private sector.

Privately financed infrastructure projects raise government concerns that private sector interests may differ from public interests in certain respects. The task of the host government is to structure private participation to protect the public interest while obtaining the benefits of private investment.

Public-private partnerships ("PPP") provide such a structure. A PPP can generally be defined as a form of collaboration or joint endeavor between the public and private sectors for the purposes of developing, constructing, operating and financing an infrastructure project.[1] A PPP is documented by a series of interrelated agreements between the public and private participants which define their respective rights and responsibilities with reference to the corresponding legal and policy framework.

This Negotiation Platform (this "Platform") is intended to facilitate and ensure the implementation of PPPs by providing a basis for training in negotiation of PPPs for public officials charged with infrastructure development. The Platform is designed to provide a balanced approach to reconciling and harmonizing the interests of the public and private sectors. Annex A sets forth a brief description of the manner in which this Platform may be used.

It must be emphasized that the Platform assumes a certain basic understanding of infrastructure projects and knowledge of the important factors of conventional procurement of such projects where private parties construct the project facilities and the public sector operates the facilities.

Training with respect to the specific issues arising in a PPP is only one aspect, albeit an important one, of the information needs of government officials who are negotiating the terms and conditions of a project on behalf of the host country. To be effective in negotiations, the government official must also have the requisite authority to make all material decisions, save

[1] "Public private partnership" is not a precisely defined term. It embraces a range of structures and concepts which involve the sharing of risks and responsibilities between the public and private sectors. The approaches and techniques range from the simple commercialization of a set of assets that remain under public ownership right through to virtual privatization. The way in which risks, responsibilities and powers are allocated between the public and private sectors will vary enormously from structure to structure across this spectrum.

perhaps some more fundamental, and should have enough years of experience to be seasoned in his dealings with his counterparts.

Regardless of how effective a government official may be in negotiating a PPP, his effectiveness will be enhanced by having recourse to suitably qualified consultants and advisors who can bring to bear additional analytic and manpower resources and international experience. In addition, they can enhance communication with the private parties' advisors and consultants.

It is important to emphasize that this Platform has not focused on any individual infrastructure sector but rather has highlighted the major issues relevant to PPPs generally. To the extent that certain issues may apply differently to individual sectors or types of infrastructure, or apply particularly to any one sector, brief explanations sometimes have been set forth in passing. It should be emphasized, however, that issues raised in this Platform may have differing implications, and preferred approaches, depending on the applicable infrastructure sector.

To be effective, negotiators should also be aware of (1) the specific sectoral issues raised in the context of each of the issues covered within this Platform or otherwise and (2) how those issues have been handled in developing countries that have been successful in encouraging private sector infrastructure investment. Although essential to the training of a government official, an examination of the relevant specific sectoral issues lies beyond the scope of this Platform and must be pursued subsequently.

Part II of this Platform discusses the basic structure of PPPs, including the principal parties and agreements. Part III examines principles of risk allocation. Part IV analyzes the major interests of the host government, the private sponsors and the lenders with respect to a PPP. Part V deals with pre-development phase procedures and documents. Part VI analyzes issues related to project construction and completion. Lastly, Part VII discusses generally the most significant issues related to the operation of a PPP infrastructure project.

II. Structure; Principal Parties and Agreements

A. Structure of the PPP: the BOT Model.

While PPP structures can take several forms, the BOT model is one model of infrastructure finance that is used when the government seeks to eventually acquire, by transfer, an asset that has been developed, constructed, and operated for a fixed term by the private sector. Without suggesting that the BOT model is the only appropriate model for infrastructure development, for purposes of discussion and analysis, it has been chosen to provide the analytical framework for this Platform. In its simplest form, a BOT project involves a grant by the host government to private sector parties of a right (which, depending on applicable law in the country, may be based on contract or involve the issuance of a license or a concession) to own and operate a project, for a determined length of time -- often up to 30 years and sometimes more. The private sector parties develop and build the project, and then operate and manage the project for the duration of the agreed term subsequent to completion of construction with the goal of recouping construction, operation and financing costs and making a profit from the proceeds coming from the operation of the project. Under the BOT model, at the end of the contract term, the project is transferred to the host government.

BOT infrastructure projects are generally financed on a non-recourse or limited recourse basis.[2] That is, lending for the project generally is based upon the anticipated revenues of the project (as such revenues may be supported by the host government or otherwise) rather than the general assets or credit of the project sponsors, and collateral for such lending is comprised of the assets of the project facility, including all contractual rights and cash flow of the project.

There are two features of the BOT model that should be considered before pursuing a BOT opportunity. First, the host government, upon transfer of the project to the government, should have the managerial expertise and technological capability to effectively control and operate the project. Second, the contracts should create incentives for the private sponsor to ensure that the project, at the time of transfer, will be capable of being operated economically and efficiently for its expected remaining useful life.

The BOT model provides governments with a means of extending a limited form of privatization into the development of infrastructure. It should be emphasized, however, that the BOT model is not the only model to achieve privatization objectives in the development of infrastructure, nor in the specific case necessarily the best model to promote the interests of the host government. Each project must be carefully examined, analyzed and evaluated individually to determine the appropriate financing and ownership structure. Other models include: build-own-operate (with no transfer), build-lease-transfer, build-transfer-operate, and rehabilitate-operate-transfer.

Attached as Annex A is a chart setting forth a typical BOT project structure with the relevant parties and agreements indicated.

B. <u>Participants in the PPP</u>.

- Project sponsor.

The project sponsor(s) typically are private companies, and may include the main contractor(s) for the construction of the project facilities and the operator(s). Private investors (e.g., institutional investors/funds) may also be sponsors (and the host government and/or public entity may similarly be an equity investor in the project). The sponsors oversee and lend impetus to the development of a project and, if there is no transfer, also receive the residual value of the project after the debt obligations of the project are fully paid.

---

[2] Project financing usually entails some form of limited recourse, meaning there are limited obligations and responsibilities of the project sponsor. The amount of recourse will normally depend on the particular risks presented in a project and the willingness of the credit market and project sponsors to take such risks.

- Project entity.

Depending on the provisions of applicable law, the project is undertaken either by a corporation (a so-called special-purpose corporation), or a partnership specifically established for the project. Such entity will enter into the relevant project and financing agreements and will own and operate the project assets.

- Commercial lenders.

The commercial lenders are customarily private banks, insurance companies, credit corporations and other financial institutions, based either abroad or in the host country. Often, the majority of the debt financing raised for a project comes from the international financial markets.

- Multilateral and bi-lateral agencies.

The World Bank, International Finance Corporation, regional development banks and other international entities, as well as bilateral export credit agencies, provide significant credit support for infrastructure projects, particularly in the developing countries. These entities (other than the World Bank) may also provide debt or equity financing for the project.

- Contractor.

The contractor is responsible for construction of the project facilities and generally is responsible for the containment of construction-period costs. Sometimes, the contractor may be a group of companies (i.e., a consortium) undertaking the construction on a joint and several basis. The contractor typically is expected to enter into a fixed price, turnkey construction obligation, meaning that the contractor must deliver a fully completed project, demonstrated to be operational, at a pre-determined lump-sum price. A common form of construction contract, entered into by the contractor and the project company, is the so-called "EPC Contract," which covers the engineering (and design), procurement and construction aspects of the project. If the contractor is a shareholder of the project company at the time of contract negotiation or later, a conflict of interest may arise in the negotiation and implementation of the construction contract between the project company and the contractor.

- Operator.

The operator is responsible for the operation and maintenance of the project. The operator customarily receives a service fee, which is subject to upward or downward adjustments based on performance results of the project. If the operator is a shareholder of the project company at the time of contract negotiation or later, a conflict of interest may arise in the negotiation and implementation of the operation and maintenance agreement between the project company and the operator.

- Supplier.

The supplier is responsible for the delivery to the project of necessary fuel (for a power project) or utility services (such as water and electricity). For power projects using fossil fuels, project sponsors and lenders are concerned with the underlying economics of the supply arrangements (in relation to expected revenues) and the ability of suppliers to perform their contracts (including payment of damages in the event of nonperformance).

- Product purchaser or project user.

The product purchaser or project user purchases all or some of the product or service provided by the project. Project sponsors and lenders are concerned with the payment and performance risk presented by the product purchaser or project user, as the payments from the product purchaser or project user constitute a major element in determining the financeability of the project.

- Host government.

The host government is involved in the issuance of permits, authorizations and, if applicable, the project license or concession, and may additionally be involved in the project in other ways, including as equity contributor, payment guarantor, supplier of raw materials and other resources, product purchaser, or provider of financial or credit support. The host government sometimes grants tax concessions to the project company and may provide foreign exchange availability assurances. The host government also may play a crucial role as public regulator of the project and, in such capacity, may affect the tariffs, tolls, fees or other vital aspects of the project.

- Insurance providers.

The project sponsors will procure all insurance coverages required by applicable law. In addition, the terms of the service agreement and the requirements of lenders often result in the need to obtain a broader portfolio of insurance policies and coverages. Finally, project sponsors may seek additional insurance coverages, such as political risk insurance, to protect their investment.

C. <u>PPP Agreements.</u>

The following are some of the main agreements involved in a PPP infrastructure project:

- Project or concession agreement.

The project agreement is the central agreement of the project, setting forth the critical revenue provisions and performance obligations. The name of this central agreement may differ from project to project, depending on the type of infrastructure involved or on local legal issues. For example, in power projects, the project agreement is the power purchase agreement, comprising the understanding between the project company and, typically, a public utility; in a motorway or railway project, the services agreement may be in the form of a concession agreement, although the laws of a particular country may render advisable calling the central agreement by some other name, e.g., a design, build, finance and operate agreement; in a pipeline project, the central agreement is generally called a transportation agreement.

- Construction contract.

The construction contract is the agreement between the project company and the contractor, setting forth the terms and conditions of the construction of the project.

- Operations and maintenance agreement.

The operations and maintenance agreement is the agreement between the project company and the operator, setting forth the terms and conditions of the operation of the project.

- Shareholders agreement.

The shareholders agreement is the agreement among the shareholders of the project company. The host government may or may not be involved directly in the negotiation of the shareholders agreement, depending on whether the host government is an equity participant in the project company.

- Government support agreement.

Often, the host government will be required to provide financial or other support to a project. The terms and conditions will be set forth in some type of government support agreement, such as a payment guaranty or an implementation agreement.

- Financing agreements.

The terms and conditions of the debt financing of a project will be set forth in the financing agreements. If funds are borrowed from a syndicate of banks, the main financing agreement will be the credit agreement between the project company and the agent for the bank syndicate. If funds are borrowed from the capital markets, the main financing agreements will be the trust indenture or note purchase agreement.

- Other Agreements.

Other ancillary agreements are also customarily entered into, such as a fuel supply agreement, a land lease agreement (or land purchase agreement), sponsor support agreements, security agreements, an escrow agreement and warranties and warranty bonds. The particular facts and circumstances of each transaction may additionally require further ancillary agreements between the relevant parties.

III. Principles of Risk Allocation

An important part of any project is the structuring of project risk. The identification, analysis, mitigation and allocation of risk are crucial to the planning and success of every project. By structuring project risk appropriately, the project participants can maximize the likelihood that the project will be successful. The fundamental principle of risk allocation is that risk should be allocated, by contract or otherwise, to the party best able to mitigate or control such risk. Economic benefits should be adjusted in relation to the risks assumed. If the private investor is subject to relatively few risks, the return on its investment should be lower than if it is asked to assume broader risks. Financial responsibility for project risks should be allocated to the project parties who are willing to assume such responsibility and are also sufficiently creditworthy. Certain risks may not be able to be assumed by a party if they cannot be controlled or mitigated and present the risk of loss of the private party's investment, or the party's credit is insufficient to support the assumption of risk.

Applying the above principles, for example, contractors to the project should be expected to accept risks which are linked to the construction of the project facilities and the operator should be expected to accept risks which are linked to the operation of the project. With very few exceptions, project risks are not assumed by the lenders. Project sponsors are expected to bear performance risks (which risks are, in part, transferred to contractors, suppliers or operators). As project financing generally is of limited or no recourse to the sponsors, equity investors are often not willing to risk more than their initially committed equity. Typically, host governments are willing to accept political risks in the host country, which include, for example, legislative changes, failures and interference of host government authorities, currency inconvertibility, and sometimes general strikes and other non project-specific labor related interference, political unrest, war and similar events involving the host country. Host governments do not normally accept the commercial or financial risks of a project unless this is needed, to a defined extent, to make the project viable from the perspective of the lenders and the project sponsors or to address other public policy objectives of the host government, such as providing better road access or power availability to a particular region of the country or maintaining tariffs at subsidized levels below the cost of production. To the extent any risks can be covered by insurance at a reasonable cost, insurance is a natural and readily used means of covering risks, with the costs of insurance included in the project's pricing.

It is important to understand that each project participant has its own perspective on risk allocation and that the willingness of a party to assume risk depends on its perspective and subjective evaluation of risk. As a result, negotiations often focus on risk allocation issues and the willingness of parties to seek compromise through a sharing of risks and rewards.

A common tool in structuring project risk is the creation of a risk matrix, a tabular format setting forth the various project participants, an analysis of the relevant project risks, any mitigation measures deemed appropriate, and the allocation of risks to specific participants. As part of this matrix, it is important also to identify the consequences deriving from the occurrence of a risk for the party/ies who have agreed to assume such risk and for those who do not bear such risk. The consequences can take the form of either cost compensation or cash contribution as a subordinated loan which ranks junior to the loans of lenders. In some instances the relevant consequences may be termination or extension of the project agreement. Attached as Annex B is a sample risk allocation matrix.

IV. Interests of the Parties.

A. Fundamental Interests of the Host Government with Respect to the PPP Structure.

In implementing PPPs, host governments typically wish to protect certain fundamental public interests:

- Continuity at all times of the project services or product.

  The host government will seek contractually binding assurances of performance by the project sponsors, with payments for damages for substandard performance (and in some cases, bonuses for superior performance). Parties often focus on obtaining a fair balance of penalties and incentives to assure performance at expected levels. The host government may also wish to ensure the continued provision of the services through the right of the government to temporarily take over the operation of the project in the event of a default by the project company or for certain other reasons the private sector parties fail to provide the services. Such right of the host government may be required to be balanced by a right of the private parties to be compensated for their costs (such as debt service payments).

- Satisfaction at all times of environmental protection, health, safety, security and quality standards applicable in the host country.

  The host government should make certain that the project will meet applicable environmental requirements, as set forth in local law and regulation, and will satisfy the environmental concerns of any participating multilateral institutions, whose environmental standards may be more rigorous than local law and regulation. Health and safety standards should similarly be satisfied.

- Appropriate prices charged for the project services or product.

  In respect of prices for the project services, governments focus on three considerations: (a) can the project perform at the proposed price (in other words, have project expenses been underestimated or assumed to be incurred at subsidized levels), (b) are the prices similar to those offered by comparable projects in the region, and (c) will the required price to be paid by the ultimate user(s) or customer(s) of the service be low enough to permit the user(s) or customer(s) to benefit significantly from the development of the infrastructure (in relation to current prices or available income) or will subsidies be required?

NEWYORK 4064048v1

- Non-discriminatory and fair treatment of customers and users.

If the service is offered to multiple customers or users, the provision of project services or product must be done in a fair and non-discriminatory manner to the customers and users of the host country. Some price discrimination, i.e. differential prices paid, may be justified on an economic basis or social basis (e.g., for elderly or disabled persons), when authorized by the government.

- Appropriate level of disclosure of information on operations and activities of the project company.

The host government should ensure that it remains informed on all material developments with respect to the project and the project company, including without limitation, its financial situation. Typically, the host government will require the project company to provide periodic reports. The extent of required disclosure, and of host government access to the books and records of the project company, requires consideration of what is appropriate for the project. A project that charges prices on a "passthrough basis" should be expected to provide more frequent and detailed information than other projects.

- Flexibility to meet changed conditions in the future.

The host government may wish to reserve the right to request an expansion or increase in the project facilities and/or services to meet additional demand. The government may also seek a right to terminate the project, or request reduced output or prices, as market circumstances change. Sponsors, however, will face difficulty obtaining debt financing when such rights are not linked to an obligation to provide appropriate compensation to the project sponsors. The project sponsors, on the other hand, may seek a priority or exclusive rights to expand or increase the project services to meet additional demand.

- The project should fit the current or anticipated future market structure.

In many countries, certain sectors are in a transitional stage from full government ownership (whether through investment in new projects or privatization of existing companies). The proposed project should be consistent with market structure plans, and should not create unmanageable impediments to implement planned market structure changes.

- The benefits of competitive bidding should be evaluated and appropriate procurement systems adopted.

Numerous countries use competitive bidding to be able to (a) assure that policy and pricing objectives guide proposals and (b) compare projects bids on an objective basis.

- These considerations, to the extent applicable, and other matters specific to the project, should be born in mind when the project is structured, negotiated and implemented. They typically have a significant influence on negotiations, and their implications should be fully understood by government negotiators.

It is commonly recognized that infrastructure investment needs in developing countries in particular far exceed the fundraising and investment capacities of host governments and that therefore it is a fundamental interest of such host governments to foster the inbound private investment needed to address such infrastructure investment needs. The significant and urgent need for private investment, however, must not prevent host governments from diligently assessing the merits of proposed infrastructure projects. Host governments must also be careful to avoid letting the need for private investment distort their judgments about what may constitute fair terms and conditions. Perceived necessity has led governments to commitments to projects that meet a short-term need, but present adverse long-term consequences.

B. <u>Fundamental Interests of the Private Sponsors with Respect to the PPP Structure.</u>

For private investors in PPPs, certain interests are fundamental:

- Sufficient legislation and regulation should exist to assure protection of private investment. Such protection should also cover the rights of the private parties to the project and its operation. Similarly, sponsors required an appropriate level of assurance that changes in law or regulation will not have adverse economic effects or, alternatively, adjustment of certain economic terms of the original investment impacted by the change in law or regulation.

- All required concessions, licenses, permits, and authorizations must be able to be obtained in a timely and non-discriminatory manner. Project sponsors must be able to rely on the enforceability of such approvals against the government and third parties in accordance with their terms, or if changes are made, on the right to notice and administrative procedures which ensure that such approvals are not amended or revoked without due process.

- The host government and authorities should have authority to grant the required concessions, permits, consents, and licenses and to enter into the necessary project agreements with the relevant private parties.

- The law must be clear as to the right of private parties to own and operate the project and the project assets.

- The law must provide for the creation and enforcement of security rights in the project assets, including government approvals and licenses and revenue contracts. The law must also allow the project lenders and/or their designee to take over and operate the project in case of default by the project company.

- If the source of project revenue is in hard currency, the project sponsor will want payments to be made in such hard currency to bank accounts outside the host country. If (as is most often the case) project revenues are paid in local currency, sponsors and lenders will want assurances of currency convertibility and transferability in order to (a) service the foreign debt and (b) repatriate dividends in hard currency.

- Disputes between private investors and the host government and between private investors and other parties should be resolved by arbitration tribunals and/or independent and impartial courts applying principles of due process and whose rulings are legally enforceable. In cases of arbitration, the host government will be asked to submit to the jurisdiction of the arbitration tribunal and the relevant reviewing bodies in such a manner that the decisions of the arbitrators are legally enforceable against the government as well as the private investors. International practice generally provides that except in countries whose legal system conforms to international norms, the dispute resolution should take place in a country other than where the project or the investors' principal place of business is located.

In general, private investors in PPPs need a solid, reliable legal framework and system in which they can have confidence that their interests will be fairly and adequately treated.

In structuring, negotiating and implementing PPPs, the host government negotiators should understand and seek ways to accommodate these fundamental interests of the private investors, in a manner not inconsistent with the government's interests.

BOT projects have facilitated entry into economic sectors that were formerly closed to private investors, such as transportation, telecommunications and power generation. Since the demand for infrastructure services is strong and is predicted to grow dramatically in the years ahead, in developing nations, BOT projects offer the prospect of significant investment for many years to come.

Moreover, in some countries the BOT model tends to ease a host government's aversion to foreign ownership by requiring transfer of the project after the agreed upon project term. More strategic and financial opportunities, consequently, become available to private investors through BOT projects.

C. Interests of the Lenders.

Lenders often are not present or even identified at the time the host government and the private sponsors initially negotiate and execute the project agreements. The role of lenders, however, in a project financing is crucial, and their interests should therefore be incorporated into the structuring of the project, and the negotiation of the project agreements to facilitate the financing process and to avoid the need to amend the project agreements at the time of financing. The host government and the private sponsors have a mutual interest in reducing the transaction costs and time involved in producing project documentation acceptable to the lenders.

The lenders will generally have several main concerns, among others, with respect to the project agreements:

- The lenders will need to be persuaded that the income from the project, as supplemented by any credit enhancement or support, will be sufficient to repay all of the debt obligations of the project company and hence will generally be concerned with (i) the strength of the underlying economics of the project, (ii) the viability of the terms and conditions of the main project agreement with the host government and the other project agreements and (iii) the creditworthiness of the companies or state agencies which may be parties to the project agreements (such as the power purchaser) or, where such companies or agencies are of insufficient creditworthiness, the creditworthiness of any sources of credit support provided with respect to their obligations (e.g., central bank payment guaranties).

- The lenders will need to be provided with a security interest in the project assets, including without limitation, the shares of the project company, the project revenue contracts and the rights of the project company in connection with the project agreements and the tangible and intangible personal property of the project company.

- The lenders will want to be provided with as much credit enhancement as is justified by the circumstances, including without limitation, sponsor guaranties, a government guaranty or support facility, a debt reserve escrow account, a substantial equity cushion and/or multilateral institutional support. Although lenders generally will want as much credit enhancement as possible, the actual need for the host government or sponsors to provide credit enhancement is country and project specific.

- The lenders will likely require a share retention obligation on the part of the private sponsors to ensure continued interest in developing and operating the project. See Pt.V.B below.

- The lenders will expect repayment of all debt obligations, including principal and interest, in case of termination of the project revenue contracts, regardless of the cause of termination.

- The lenders will want to have “step-in” rights, which grant the right to assume or have assumed by a qualified third party the rights and obligations of the project company in case of default under the project agreements.

For purposes of dispute resolution, lenders will usually prefer final and binding arbitration in a neutral forum and generally consider the UNCITRAL arbitration rules to be acceptable. The applicable arbitration rules are, of course, subject to negotiation by the parties. Host governments generally prefer the UNCITRAL rules, but many Asian projects use the rules of the London Court of International Arbitration (LCIA), the International Chamber of Commerce (ICC) or the International Center for the Settlement of Investment Disputes (ICSID).

In general, these concerns are legitimate and should be properly addressed. For the host government an important concern is the potential requirement of host government support in various forms. The host government has a legitimate interest in minimizing its direct financial support and its indirect financial support in the form of government payment guaranties and should provide only such support as may be necessary to satisfy reasonable and substantiated requirements for financing. Although the host government may be asked or expected by the lenders and/or private investors to provide credit support to a project, many BOT projects have been done in Asia without government support (e.g., in the Philippines, China and Indonesia, although some of the early BOT projects in these countries did involve payment guaranties). The assessment of BOT projects by governments and international financial institutions subsequent to the Asian financial crisis has generally concluded that host governments, in the related project risk allocations, have generally assumed too many risks and provided too many guaranties.

In this respect it is important to understand that lenders have an interest in protecting the cash flow of the project, whereas the project sponsors additionally wish to protect the return on their investment.

To address the interests of the lenders, therefore, government support in some cases does not need to take the form of a direct payment obligation but could instead take the form of a subordinated loan ranking junior to the loans of the lenders. The terms and conditions of the project loan agreements acceptable to the commercial lenders do not necessarily coincide with the terms and conditions acceptable to the government entity providing subordinated debt.

In particular, when events occur during project implementation which may require the host government to contribute funds to the project (whether directly or in the form of a price adjustment), these distinctions between the interests of the lenders and the project sponsors and between the interests of the lenders and governmental parties could be of importance. To satisfy the lenders it may be enough to protect debt service payments by supporting the project company's ability to maintain certain ratios relevant to the ability of the project company to service the project debt, but the maintenance of such ratios or, more generally, the ability of the Company to make debt service payments, may not necessarily be adequate to protect the required return on the project sponsors' investments nor consistent with the general objectives or policies of the governmental entities providing subordinated debt.

V. Pre-Development Phase Procedures and Documents.

A. <u>Project Scope.</u>

It is important for the host government and the project sponsors to clearly define the scope of the project, and, in particular, to agree upon the sources of revenues for the project company and the corresponding obligations of the project company. What is included within the scope of a project will be crucial to the lenders in deciding whether the project is financeable and therefore should be negotiated carefully. For example, whether a project company is granted secondary development rights, see below Pt. VII. T, and to what extent, will affect the amount of expected revenues from the project and, therefore, the ability of the project company to pay its debt obligations.

Similarly, all rights and obligations of the host government vis-à-vis the project company and the project sponsors need to be carefully identified and defined. This is particularly important in relation to the matters covered in a government support agreement. See Pt. VII.I below.

It is generally advisable for host governments not to include in PPPs any undertakings which are not essential to the project. The actual scope and responsibilities of any project will depend on the circumstances of the individual project. However, both parties will have a mutual interest in clarity of definition.

B. Project Company Organization.

- Formation/incorporation.

The project company is typically a special purpose company incorporated in the host country specifically to develop and operate the project, thereby permitting lenders to focus exclusively on the project per se in making their credit risk assessments.

The host government generally prefers local incorporation of the project company to facilitate greater regulatory control and tax powers over the project, as well as for political and, in some cases, constitutional reasons.

The main interest of the project sponsors in connection with the incorporation of the project company is to limit their liability with respect to the project, comprising the foundation of their non-recourse participation in the financing of the project. Moreover, the project sponsors will be interested in local incorporation of the project company in order to take advantage of beneficial treatment given to local entities, such as local tax holidays pursuant to an investment statute or access to government-sponsored labor training programs or government subsidies. The project sponsors also want to be assured that the project being undertaken through a local company will not affect any investment protection otherwise afforded them under local laws or international treaties.

- Share ownership.

The initial shareholders of the project company are generally required, at least until completion of construction and more often for some time thereafter, to maintain a minimum level of equity in the project company, determined either as a certain percentage of total project costs or as a percentage of shares outstanding. If the project company is jointly owned by private sponsors and public/government entities, the project agreement will customarily set forth the structure of project company ownership, including the percentage ownership of the private sponsors and, the public/government entities, respectively.

The host government will prefer that the private sponsors maintain their initial levels of capital contribution during the development and operation of the project, as their participation in the equity of the project company serves as an incentive for them to support the project company. In determining the structure of project company ownership, the host government sometimes may have an interest in owning a larger portion of the equity, for purposes of sharing in the economic profit of the project and to make the project politically more acceptable.

The private sponsors and the lenders will prefer that the project company be under the control of the private sector, not the host government or any public entity. In their view, only if the private sector is ultimately in control of the project company and its operations will lenders and investors be confident that the project will have the maximum likelihood of being run efficiently and successfully. The project company may sometimes benefit, however, from having a government shareholder, for the government then has a direct vested interest in the success of the project and may therefore be less inclined to take actions materially adverse to the project's economic or other interests.

- Capital contributions.

Contributions of capital to the project company, whether in-kind or in cash, will normally be negotiated and specified as part of the project agreement. If capital contributions are to be made over time, their schedule and amounts should be precisely established, and letters of credit or similar instruments (for the contributions of the private sponsors) and, if applicable, payment guaranties should be provided in support thereof. If contributions are in-kind, the method of valuation should be agreed upon.

The host government and the project company have a mutual interest in securing as much contribution of equity from the project sponsors as possible for purposes of providing the project company with an equity cushion against unexpected expenditures or less than expected project revenues. The larger the equity cushion, the easier will be the financing for the project generally. However, risk capital in the form of equity has a higher cost than loans, i.e., the equity investors in a project will require a higher rate or return than the lenders.

- Share/equity retention.

The project sponsors are typically requested to retain their original levels of share ownership in a project company for a specified period, usually at least until construction completion or often longer, in order to assure their continued interest in the project.

The host government may prefer that the project sponsor maintain continued participation due to their familiarity with the host country and the project and their selection (i.e. by the host government) based on their credentials/experience.

The project company and the lenders have a similar interest in retaining the original project sponsors, because the original project sponsors will be more likely to operate the project efficiently. The project sponsors, however, often want to divest their shareholdings in the project company when their active role in the project, e.g., as contractors, is finished.

C. Transparent and Fair Bidding and Selection Process.

The process of selecting a project proposal should be done according to criteria understood and recognized by all potential project sponsors, which is either reflected in legislation or memorialized in formal requests for proposals. Specific procedures comprising any such process must be executed in a manner of fairness. In Asia there are examples of BOT projects adopted within a framework law (e.g. Philippines) and those adopted without a framework law (e.g. Pakistan). A framework law provides greater stability and predictability, including providing government officials with clear guidance as to the procedures to be followed and the parameters within which negotiations are to be concluded.

Depending on the laws of the host country, the award of a particular contract may be done pursuant to direct negotiations with a sole bidder (through an unsolicited bid or otherwise). This Platform does not address the question of whether all projects should be competitively bid or whether negotiated projects should be permitted, which may be an important issue for governments just beginning PPP infrastructure projects. It is assumed that the selection of a project sponsor occurs through a public solicitation of tenders. Some BOT regimes (such as the BOT law in the Philippines and the new Foreign Investment Law in South Korea) contemplate procedures for both types of selection process, requiring sponsor-proposed projects to be subjected to some limited forms of competitive procedures.

The interests of the host government and the private sponsors coincide with respect to the bidding and selection process in that both desire to maintain a transparent and fair process to ensure the efficient selection of the best candidate based on merit and to create confidence in the certainty and invulnerability of the award. Any award based on considerations not openly recognized and addressed by all participants would likely result in the granting of the project to a candidate not best qualified for the project and also render the award vulnerable to collateral attack.

The host government should avoid corruption or any other non-merit-based criterion having an influence on the selection process in order to promote the project sponsor best able to deliver the requirements of the project. The private sponsors desire transparency and fairness to avoid being precluded from projects on the basis of factors over which they have no control or awareness.

The complexity and size of PPPs generally have the effect of making the bidding process both time-consuming and costly. As a result, private sponsors will only bid if they are confident that the above considerations are recognized by the host government and that the proposed project is commercially sound and has the necessary political support. The host government should therefore prepare for the project adequately before starting the bidding process. In particular, the host government should consider if it is willing to implement the measures, including legislative and regulatory reforms needed to create the requisite confidence for the project among potential bidders. Although not widely practiced, the host government may wish to consider, as a means of conveying seriousness of intent, offering bidders who are short-listed but not awarded the project, some financial compensation for their costs and efforts.

D. Due Authorization to Grant Permits, Concessions, or Licenses.

Permits and similar approvals should be granted according to clear lines of mandated authority, preferably in the context of a legislated permit regime. The requirement of specific permits, concessions and licenses typically derives from a combination of constitutional provisions, legislative enactments and regulations. If concessions or licenses are required by the constitution but no concession/licensing regime applicable to the specific sector has been enacted by law, a specific concession/license regarding the project may need to be established.

Whether a concession or license (or contractual agreement) is used as the vehicle for conveying the legal right to develop and operate a project generally depends on local law. There are no inherent advantages or disadvantages for the host government, apart from what may be embodied in local legislation, in using licenses, concessions or contracts for purposes of granting to the private sector the right to develop a project. However, it is important to evaluate applicable law before mandating a particular approach because, in some countries, obligations (that may make private financing difficult) that arise under a licensing or concession regime are not applicable if a different approach is used.

The host government and the private sponsors have a mutual interest establishing due authorization in order to protect the project sponsors from future challenge by third parties and also to preclude any attempt by the other party to terminate or void the arrangement on the basis of a claim that the award and, if applicable, the granting of the license or concession, was not duly authorized. At the negotiation stage, the host government and the private sponsors have a mutual interest in establishing and understanding, definitively, who is duly authorized to represent the host government in order to avoid misdirected negotiations.

VI. Project Construction and Completion.

A. Timing.

The project agreement will typically establish a date for the completion of project construction. Milestones will often be agreed upon, setting forth significant stages of progress in construction and the consequences of failure to meet each milestone. In case of a delay in completion of construction, the project company may be obligated to pay "liquidated damages", which is a pre-agreed upon amount to be paid by a party in breach of a contractual obligation, typically either stated as an amount per day or other relevant time period or as a flat amount. See below Pt. VII.K. Typically, the contractor will be required to pay liquidated damages to the project company in case of completion delays for which the contractor is responsible. The liquidated damages payable by the contractor may not be sufficient to compensate the project company for the consequences of delay. An extended delay in construction completion generally gives rise to a right to terminate the project by the host government.

The interests of the host government and the project company generally coincide with respect to construction completion. Both the host government and the project company desire the timely completion of all stages or "milestones" of the project, clear definitions of completion throughout the negotiation process and in the agreements, and clear allocations of responsibility for project delays. However, the host government and the project company may not have a commonality of interest in creating an incentive for early completion. The early completion of the project provides the project company with the opportunity to earn revenue earlier than expected while the host government receives the benefit of new infrastructure earlier than planned. On the other hand, the host government may not have built all infrastructure needed to facilitate the project in time to accommodate early completion. There is precedent in Asia, however, for the host government/power purchaser paying a premium to the project company for early completion.

The interests of the host government and the project company diverge with respect to the issue of what excuses a delay. The project company will want to include as many negotiated excuses as possible in the project agreement, including among other excuses, force majeure and governmental delay. The host government will want to limit such excuses to a minimum and to provide for stiff liquidated damages provisions in the construction contract in order to encourage timely completion.

B. Project Specifications/Quality Control.

General technical specifications for project construction are customarily set forth in the project agreement. To best benefit from the private sector´s competence, it is recommendable in most cases to impose on the private parties functional and performance oriented specifications rather than detailed product-oriented specifications. Customarily, the project agreement will specify appropriate performance warranties and liquidated damages for substandard performance. It is still important, however, for the host government to retain an independent expert to monitor project implementations and performance. The project company will seek to negotiate back-to-back liquidated damages provisions with the project contractor and project operator.

The host government needs to make sure that the project, as constructed, satisfies the needs of the host country for the expected lifetime of the project facilities. The host government should also ensure that project specifications comply with any relevant health, safety, security and environmental standards, as set forth in law or otherwise, including, without limitation, any requirements of participating multilateral institutions (e.g., the World Bank environmental guidelines).

The project company's main interest is to ensure that the project, as constructed and operated, will be capable of performing all obligations set forth in the project agreements. A related concern, of course, is that the project be capable of generating the income needed to cover the project's operational expenses, repay its debt obligations and provide a return on its equity during the agreed project term.

C. Construction Cost/Payment.

The risk that construction of the project will cost more than the amount of funds available from the construction loan is important. Construction costs can exceed funds for many reasons, such as inaccurate engineering plans, delay, inflation, political risks or force majeure. Project construction costs should be determined on a lump-sum turnkey basis, which enables a substantial portion of the project cost to be fixed or hedged. Under the usual “turnkey” arrangement, the contractor agrees with the project company to deliver the entire project, from start to finish, for a lump-sum price. A lump-sum price is a single amount for the entire cost of completion of the project facilities.

The main interest of the host government is for the project company to bear the risk of project cost overruns with the understanding that overruns resulting from force majeure or governmental action (or delay) may be the responsibility of the government. The project company, in turn, will want to shift all of the risk of cost overruns to the contractor, and the contractor will include in the lump-sum price for construction a certain “contingency” amount above anticipated actual costs in order to compensate for the risks involved.

D. Modifications.

The project contractor is typically entitled to request a change in the terms and conditions of project construction and an extension of the time agreed for the completion of the project facilities upon the occurrence of a limited set of circumstances outside its control (a “change order”). The project company obtains corresponding rights to request changes. Usually, the contractor is required to exercise best efforts to mitigate delays and additional costs associated with requested changes.

The additional costs resulting from change orders will be of concern to the host government and the project company, as additional costs requiring additional debt may lead to higher revenue requirements for the project and, therefore, higher user charges or tariffs.

The project contractor will have an interest in obtaining as much time as may be necessary to implement any change in the scope of work and receiving just compensation for any extra work.

The approach to change orders should be carefully evaluated in the course of negotiating the project agreement and the construction contract.

E. Local Sub-Contractors/Employees.

The project company may be required to use a certain percentage or amount of local sub-contractors and/or local employees in the construction and operation of the project. Local subcontractors would typically be subject to the same standards of performance, warranties and liability as the international contractor, through back-to-back provisions in the relevant subcontract agreements. The project company must have some discretion in using local sub-contractors based on objective qualifications and/or performance standards.

The host government can facilitate the transfer of expertise and technology from the project company to the host country by making sure that local subcontractors/employees participate in the project. A concern may exist, however, about the qualifications of local sub-contractors and the need to provide special training and coordination with the international contractors.

VII. Project Operation and Financing.

A. Operation and Maintenance.

The project company will typically enter into an operation and maintenance agreement with an internationally reputable operator. The operator will have an obligation to operate and maintain the project facilities in accordance with terms and conditions of the operation and maintenance agreement, the other project agreements and all relevant laws and regulations, including without limitation, all relevant health, safety and environmental laws and regulations. An independent engineer may be retained by the project sponsor and/or government to monitor the operation and maintenance of the project. Liquidated damages are usually payable by the project company to the government party in case of failure to meet contractually established performance obligations. Although the project company generally is compensated by liquidated damages from the operator, that compensation may not be sufficient to cover the obligations to the government party.

The main interest of the host government is to ensure the proper and continuous operation and maintenance of the project facilities in accordance with the terms and conditions of the project agreements and all relevant laws and regulations. The host government in particular has an interest in the adequate provision of services from the project facilities, as well as the health, safety, security and environmental welfare of its people. The host government will typically reserve certain rights with respect to the project facilities in case of national emergency to ensure the continued provision of the services. If the host government should exercise rights to take over the control of the project, it must be prepared to compensate the project company and the lenders for any cost and losses incurred by them.

The main interest of the project company in the operation of the project facility is to be able to continuously operate the project facility, without interference by the host government and the local authorities or others, in a manner sufficient to both meet contractual obligations and to be able to generate sufficient revenues to cover the costs of operations, to satisfy fully all debt service obligations and to provide an adequate return on equity. The project company thus has an interest in allocating to the operator as much risk as possible with respect to the operation and maintenance of the project facilities, for example through performance guarantees, liquidated damages and fixed operating fees.

B. Permits, Authorizations, Consents.

The project company must apply for, obtain, and maintain in full force and effect, all governmental permits necessary for ownership, development, construction, start-up, operation and financing of a project. Certain rights may be granted in the project agreement itself. If any permit is not timely obtained, the project may be prohibited from proceeding, constituting a political risk which project sponsors and lenders will only accept if the reason for the failure to obtain the permit is a default of the project company. The types and amount of permits for a project vary depending on the sector, site, technology, local process and other variables. Various governmental agencies may be involved in the granting of permits, with jurisdictions ranging from local administrative districts to the national government. The obtaining of all relevant governmental permits, authorizations and consents has been a particularly problematic issue for privately financed infrastructure projects in South Asia.

The host government should support the project company in the permit process in order to promote the likelihood of project success, but it also has an interest in avoiding liability, either perceived or actual, for the project company's failure to obtain the necessary permits. Typically, the host government will provide assistance in obtaining necessary permits, authorizations and consents. At the same time, the host government, like the lenders, will customarily require as a condition precedent or subsequent to the effectiveness of the project agreement that all permits, authorizations and consents necessary in connection with the project are obtained and require the project company to covenant to maintain all such permits, authorizations and consents to the extent within its control.

The project company will want to be assured that it will obtain all necessary permits, authorizations or consents on a non-discriminatory, timely and fair basis and that they be respected by the host government authorities and third parties. The project company may thus attempt to negotiate that any failure to obtain, delay in obtaining or the revocation of any necessary permits, authorizations or consents, unless caused by a default of the project company, be considered an event of default of the host government or force majeure

C. <u>Project Revenue.</u>

- Revenue Source.

The financeability of any project depends ultimately upon the certainty and creditworthiness of its revenue source. For example for motorway or bridge projects, the revenue source is the tolls to be collected from the motorists; for power projects, the payments made by the electrical power purchaser; for pipeline projects, the payments to the project company by the shipper. Whatever the project, the price to be received by the project company for its services/product will be one of the most important terms to be negotiated.

It is essential for the host government to keep the price for services/product provided by the project company within politically acceptable parameters. Given the high profile that most infrastructure projects command, the relatively large number of persons affected and the extent to which most infrastructure services/products are perceived as basic to the lives of people, politically unacceptable price levels for such services/product tend to have significantly negative political consequences. On the other hand, the host government has an interest in making sure that the prices it is willing to pay (or have charged) are not so low as to discourage infrastructure investment by the private sector.

The project company needs to receive payment for its services/product sufficient to cover all operating expenses, payment of debt obligations and an adequate return on equity. In order to satisfy the project's lenders, the revenue structure needs to provide with relative certainty that the project will receive revenues sufficient to cover all of the fixed costs of the project, including, most importantly, the debt service obligations of the project company. Lenders will customarily not be willing to bear the risk of a reduced demand for a project's services/product and will generally require certainty regarding project revenues. For example, in power and pipeline projects, the product purchaser typically is obligated to make "capacity payments," whose levels are determined independent of the actual amount of power purchased or product shipped. In motorway projects, the host government may be requested to provide a standby operating support facility to ensure that the project company has enough resources to satisfy its debt service obligations if actual traffic levels fall below certain predicted traffic levels.

- Escalation/adjustment.

The revenue source for the project company is typically adjusted for certain changes in project variable costs, inflation, foreign exchange rates and certain other relevant, negotiated factors. The inflation and foreign exchange adjustments are keyed primarily to the debt service and capital requirements of the project company and, therefore, are generally prorated according to the relative proportions of the international and domestic components in the total project financing.

The host government can expect to be requested to facilitate the financing of a project by absorbing the risk of certain changes in the macroeconomic environment over which it ostensibly has some control, e.g., inflation and the exchange rate. Changes in the variable cost of the project or its operation, such as labor costs, may be reflected through an inflation adjustment, but changes in fixed costs (other than due to force majeure or change in law, as discussed in Pt. VII.M, below) caused by the project company or its sponsors should not lead to adjustments in price or the overall revenue stream. The host government, however, must be sensitive to the political tolerance of passing along certain increases in the cost of operating a project to the consumers.

The main interest of the project company is to seek compensation for any changes in the costs of the project over which it has no control, e.g., costs related to the macroeconomic environment. The lenders and investors generally will be unwilling to assume any risks related to changes in such costs of the project.

D. <u>Project Fees</u>.

The host government may assess the project company certain fees in addition to any taxes to be paid on income. The fees may be a certain percentage of net profits earned by the project company or dividends actually distributed to the shareholders of the project company. To the extent that project fees are based on dividends to shareholders, the fees are customarily assessed pro rata according to the percentage of equity in the project company owned by private shareholders.

The main interest of the host government in assessing project fees may be to compensate for use of national assets (royalty payments) or for obtaining a monopoly right (through a concession or licence). These fees enhance fiscal revenues generally or facilitate industry/sector-specific purposes, e.g., a national highway development fund.

The project company will view any project fees as a cost of doing business in the host country, with perhaps some indirect benefits to the extent that the fees are earmarked for industry/sector specific purposes related to its own project. To the project sponsors and the lenders it is of paramount importance that any such project fees are clearly defined at the development stage of the project, with known and definable adjustment rights, if any.

E. Government Support.

The host government will always play a significant role in a successful project financing and is generally interested in the design and construction of the project to ensure that it is done properly and on time. For example, the host government may want completion, testing, and commissioning procedures to be included in the project agreement, and may require the right to review and approve all of the material transaction agreements.[3] The project sponsors and lenders will want assurances from the host government with respect to various project issues, either in the main project agreement itself, in separate agreements or through legislation/regulations, e.g., assurances of supply of utilities and raw materials, work visas for expatriate workers and management, acquisition of land rights, assurances against political risks (such as expropriation and nationalization), repatriation of profits, protections against certain events of force majeure and change in law, and currency related protections, such as free convertibility and transfer.

The host government does not need to provide any more support than is absolutely required to attract foreign investment and participation, and should distance itself from liability for a project's economic or other failure. The host government should evaluate these requests in relation to current law, with additional assurances provided to the extent not covered by applicable law. Such additional assurances generally should be provided in a manner permitting it the greatest flexibility and requiring the least political capital, i.e., through means other than an enactment of new legislation. The perceived political risk in certain countries, however, may be such as to require nothing short of approval from the highest political organ in the country in the form of legislation.

The project company will ideally want legislative or other robust approval of as many aspects of the project as possible before proceeding significantly into the development process. For example, the project company would typically be interested in seeing the legislative adoption of any changes to the tax and investment laws needed to improve project economics. The underlying interest of the project company behind all forms of government support is economic:

[3] The project company, however, will generally grant only a consultation right, as opposed to an approval right, to the host government with respect to transaction agreements to which the host government is not a party. A strong case will exist for approval rights with respect to those contracts related to any "passthrough" provisions of the project services agreement.

to generate sufficient earnings to satisfy debt service obligations and provide a satisfactory return to equity investors.

F. Site Acquisition.

The host government, if it has the applicable land rights, typically provides the project company with the rights to use the project site, including rights of way and vacant enjoyment, but generally retains title to the land. The cost of site improvement is paid by the project company. The arrangements between the host government and the project company with respect to the project site typically are set forth either in the project agreement or in a separate lease agreement or land purchase agreement. Additionally, if it has the applicable land rights, the host government generally will have the obligation to provide for adequate access to and egress from the project site. One of the most troublesome issues in the development of infrastructure in South Asia has been site acquisition. Delays in site acquisition can be a particularly serious problem.

The main interest of the host government is to designate a project site that makes sense for the project, but does not result in development that is disruptive to the lives of its people. The condemnation of land in return for just compensation may be required, whose cost may constitute part of the cost to be born by the project company.

The main interest of the project company is to acquire on time and at a pre-determined cost all land necessary or advisable, as well as all concomitant rights, for the development, construction and operation of the project. Moreover, the acquired land must be in a condition conducive to the development of the project, i.e., clear of all structures, buildings and other potential impediments and accessible from other relevant locations. If the land has been used for other purposes, appropriate environmental indemnities may be necessary.

G. Foreign Currency Availability.

Foreign currency availability risk arises primarily because of a difference between the currency in which project revenues are received and the currency in which the project is financed. A foreign exchange shortage in the host country may lead to the project company being unable to convert local currency into the foreign currency in which the debt/equity holders must be paid. Often, the host government will be expected to provide a guaranty of foreign currency availability and convertibility.

The host government has a fundamental interest in preserving and prioritizing the expenditure of its foreign exchange reserves. Host governments generally should not commit themselves to providing any more foreign exchange than they absolutely must. Where available, political risk insurance covering foreign currency availability and/or commercial currency swaps are generally preferred by host governments for purposes of mitigating the risk of foreign currency unavailability.

The main interest of the project company is to have sufficient foreign currency to be able to pay its debt service obligations and to make any payments with respect to its equity, including dividends. Ideally, the project company would prefer the project revenue sources to make payments in foreign currency. Otherwise, the project company is generally interested in negotiating with the host government a guaranty of or priority access to foreign exchange, or at least ensuring that currency swaps can be entered into or political risk insurance covering foreign exchange availability obtained at a reasonable cost.

H. No Material Adverse Action.

The host government typically has a general obligation to refrain from taking any actions that are materially adverse to the economic interests of the project company, including (i) changes in relevant laws or regulations detrimental to the project (e.g., adverse changes in environmental and tax laws and regulations), (ii) enhancing or establishing competing projects and (iii) interruptions of construction or operations. Certain exceptions may relate to national security, the national interest or public safety. The host government usually is requested to agree that, in case of a "material adverse action," the host government will have to compensate the project company and the lenders for the added cost to and losses of the project company and the lenders resulting therefrom, or the project company may have the right to terminate the project agreement with appropriate compensation paid.

The host government needs is to preserve its political freedom in case of national security, national interest or public safety, but also has a strong interest in assuring the lenders and investors that it supports the project and will not act detrimentally to the economic welfare of the project.

The main interest of the project company is to receive an explicit undertaking from the host government to avoid any actions materially harmful to the project or at least to obtain a legal basis for receiving compensation for any actions perceived by the lenders and the investors as materially harmful to the economic welfare of the project.

I. Assurances of Payment and Other Financial Obligations.

The host government often is expected to provide financial and/or other support to the project, in one or more forms, such as capital contributions, subsidies, payment guaranties and/or an escrow account for security against governmental payment obligations. Particularly if the underlying economics of the project or the government-owned purchaser or supplier are not robust, the host government will be expected to undertake a significant and indispensable supporting role. The role of the host government, however, can usually be structured to avoid any commitments it may undertake from being counted as a debt obligation on the national balance sheet for purposes of the multilateral institutions or otherwise.

The host government will need to consider the minimum level of support it is able to provide to facilitate the development of the project, and in a way that minimizes its national debt exposure. By the same token, care must be taken to assure that commitments are not made in a manner that limits future private sector investment (or privatization).

The main interest of the project company is to provide assurance to the lenders that it will have sufficient resources to make all debt service payments and that the project sponsors will receive a fair return on the equity invested. The project company wants sufficient support from the host government to assure the lenders that the risk of the nonpayment by the project company is mitigated.

J. Requirements of International Financial and Other Institutions.

Obligations with respect to any credit enhancement or financing provided by international financial institutions, export credit agencies or other entities may be set forth in the project agreement. For example, the obligation of the host government to provide a counterguarantee to the World Bank in case of a World Bank Partial Risk Guarantee may be one of the terms and conditions of the project agreement, or compliance with the particular requirements of an export credit agency may similarly be agreed upon.

The host government and the project company have a mutual interest in facilitating the participation of international financial institutions, as their support often is the fundamental component making a project financeable. In addition to the financial assistance international financial institutions may provide, the host government seeks the international imprimatur that participation by international financial institutions lends to a project, specifically, and to the host country, more generally. The project company seeks the added stature that international financial institutions usually give to a project by virtue of their participation, viewing such added stature as an additional incentive for the host government to respect all of its obligations related to the project.

Host governments should be aware that bilateral export credit and investment insurance agencies involved in cofinancing or underwriting risks in the project will normally have significant requirements for the purchase of equipment or services from exporters of their countries. These agencies nevertheless can fulfill an important role in the leveraging of additional finance, as well as providing additional security to lenders and contractors. The contractors may wish to have access to a sufficient spread of export credit across different export credit agencies in order to permit the competitive purchase of project equipment or services. To avoid excessive duplication and due diligence, project sponsors arranging financing may wish to limit the numbers of export credit agencies involved in the project to a maximum of three or four.

It should be emphasized that international financial institutions may require adherence to standards, particularly related to the environment, which may be stricter than local legal requirements. International financial institutions may similarly impose higher standards in non-environmental matters as well, such as resettlement of individuals displaced by land acquisition for purposes of project development.

K. Remedies/Rights of Recovery.

The project agreement typically will contain specific remedies or rights of recovery for breach of contractual obligations of the parties, e.g., delay in construction completion or default in provision of services. Special remedies in PPPs include the right of the host government and lenders to “step in”, which means that the project temporarily or permanently is taken over by the host government or the lenders, as applicable, or on their behalf by a third party. Agreed upon remedies or rights of recovery customarily will be the exclusive means of remedy (other than termination) for breach of the related obligation.

The main interest of the host government in any agreed upon remedies is to enable the services to continue and to obtain fair and equitable compensation for the relevant breach of contract in an expeditious manner. Liquidated damages are a common form of providing for compensation in case of breach of contract: they comprise an amount that the parties agree upon ahead of time with respect how much the party in breach of its obligations must pay in order to compensate for such breach. Typically, the amount to be paid by the party in breach is stated per diem or some other relevant time period, per occurrence or as a flat amount. The appeal of a remedy in the form of liquidated damages for the host government is that it creates a clear incentive for the project company to perform and that it dispenses with the need to prove damages in any dispute and thereby accelerates the dispute resolution process and compensation to the host government.

The project company similarly has an interest in obtaining fair and equitable compensation for a breach by the host government in an expeditious manner and in speedy and efficient dispute resolution proceedings. For the project company as well as the lenders the protection of the cash flow of the project is of paramount importance. This may result in the use of special dispute resolution methods in particular during the development stage, such as the use of a dispute review board which can render interim directions to the relevant parties. The appeal of liquidated damages for breach by the project company is the relative certainty the agreed upon compensation establishes with respect to the liability of the project company. Moreover, liquidated damages as a remedy generally also impose a ceiling on the liability of the project company, either with respect to one particular contractual obligation or an entire set of contractual obligations.

L. Termination.

- Events of default.

The events of default are the events which may form the basis for termination of the project agreement, e.g., failure to make payments timely, excessive delay in construction completion, material default in provision of services, bankruptcy or liquidation of the project company, abandonment of the project by the project company, sale of project assets, contract repudiation. Notice is generally required to be given to the defaulting party and to the lenders before an event of default may be declared. Also, certain grace periods are usually granted to the defaulting party to remedy the relevant breach, and typically the lenders are given an opportunity to cure any default on the part of the project company before the government may terminate the project agreement. See below “Lenders’ Rights and Remedies,” p. 31.

The host government and the project company have a mutual interest in providing for termination of the project in case the other party commits a material breach of contract, which is not cured. Both parties, however, have an interest in permitting and encouraging cure of any default, whether by the parties themselves or by the lenders, to permit continuation of the project where feasible.

- Compensation.

Compensation upon termination of the project agreement may be provided by the host government to the project company upon termination. Typically, if the project company is the cause of termination by the government, compensation is limited, sometimes to payment to the lenders of the outstanding debt obligations of the project company and sometimes to a payment related to the residual value of the project assets. In case of termination by the government for the project company's default, the project company most likely will be in bad financial condition and thus will have limited capacity to pay damages to the government. If the government is the cause of termination by the project company, compensation generally covers outstanding debt and equity, including an agreed upon return upon the equity. If the cause of termination is neutral, such as certain force majeure events, compensation will generally include at least payment of the outstanding debt obligations of the project company plus in some cases a component of equity and in some cases also a certain return on equity. In all cases of termination, the project facilities would be transferred to the host government.

The main interest of the host government is to have the project facilities transferred to it as smoothly as possible upon termination so that the provision of the project services can continue with minimal interruption. Generally it has been necessary to provide assurance to the project's lenders that they will receive payment on the project company's debt obligations regardless of who is at fault upon termination. In case the government is at fault, the host government should provide fair and equitable compensation to the equity holders of the project company to avoid discouraging future investors.

The main interest of the project sponsors is to receive fair compensation for the project assets to be taken over by the host government and to receive a fair return on investments made in the project. They also generally have an interest in the lenders being paid the outstanding debt obligations of the project company and compensation for losses.

M. Force Majeure/Change of Law.

Force majeure is any event beyond the reasonable control of the parties, e.g., war, revolution, riot, insurrection, civil commotion, floods, earthquakes, unusual weather conditions, fires, strikes, whose occurrence could not have reasonably have been foreseen at the time of entering into contract and which materially affects the project. Force majeure generally provides an excuse from performance of contractual obligations. Extended periods of force majeure may give rise to termination rights by either party. Specific events of force majeure sometimes are listed for purposes of certain obligations.

Change of law is an alteration of the legal framework which, if to the detriment of the project, typically gives rise to compensation to and excuse from performance of the project company.

Force majeure provisions are important in allocating risk to the parties and therefore play a significant role in determining liability and in termination provisions. The host government has an interest in generally construing force majeure provisions narrowly for purposes of not exempting the project company from liability for failure to perform its obligations with respect to the development and operation of the project. For purposes of termination compensation, the host government similarly would prefer to construe force majeure provisions narrowly, as termination of the project as a result of force majeure typically is viewed as a "neutral" termination triggering at least partial compensation to the equity holders of the project company.

The project company has the opposite interest of generally construing force majeure provisions broadly, as the project company typically has the more significant performance obligations under the project agreement.

N. Independent Engineer.

Sometimes an independent engineer is appointed with the consent of both the host government and the project company to serve as an independent arbiter of technically oriented disputes or questions. The costs of the independent engineer are sometimes paid by the project company. Both the host government and the project company have an interest in retaining a qualified, experienced and impartial independent engineer, but will want an effective dispute resolution mechanism in case of disagreement with the independent engineer.

O. Insurance.

Before construction completion, the project company typically is required to obtain insurance relating to construction risks, e.g., contractor's all-risks insurance, third party liability insurance, employer's liability insurance and completion delay insurance.

After construction completion, the project company typically is required to obtain insurance relating to operational risks, e.g., property and casualty insurance, third party liability insurance, business interruption insurance, employer's liability insurance.

The interests of the host government and the project company coincide: both as well as lenders desire to that the project company will have sufficient financial resources, in case of material damage or harm to the project's construction or operations, to satisfy the project company's debt and other obligations.

P. Environment.

The project company is generally required to comply with all relevant environmental laws, rules and regulations, including the relevant laws of the host country and the guidelines of any participating multilateral institutions, e.g., the World Bank environmental guidelines. Compliance with environmental guidelines and requirements may sometimes be the most difficult aspect of any project's implementation.

The main interests of the host government are to protect the environment of the country, as required pursuant to local law and regulation, and to satisfy the environmental concerns of any participating multilateral institutions, whose environmental standards often are more rigorous than local law and regulation.

The main interest of the project company is also to achieve environmental compliance but at the lowest possible cost to the project company.

Q. Project Company Disclosure/Reporting.

The project company may be requested to provide periodic reports to the host government and lenders with respect to its financial and other performance and its assets. Annual reports may be required to be audited by an independent auditor in accordance with appropriate accounting standards.

The main interest of the host government is to monitor the financial performance of the project, particularly if the government is a shareholder of the project company.

The main interest of the project company is to provide its shareholders and lenders with adequate information about the financial performance of the project.

R. Term.

The term of the project agreement needs to be sufficiently long in duration to permit the project company to earn enough income to pay all of its debt obligations plus an adequate return on its equity, often at least 20 years, depending on the type of project. The term may be extendable, subject usually to certain conditions related to project performance and mutual satisfaction of the parties. The term of the project may also be extended as a means of compensating the project company for losses in certain situations, e.g. change in law or force majeure, the discovery of hazardous waste, etc.

In a BOT project, the main interest of the host government is to receive the transfer of the project facilities as soon as such may be in the economic or political interests of the host government. For non-BOT projects, the government may desire to be free to pursue other projects at a time which is convenient to the government. It may be in the interest of the host government to permit the project company to continue to operate and maintain the project by extending its term if the arrangement is working to the mutual satisfaction of both parties. Extending the term of the project effectively continues the “privatization” of the project facility, keeping the project under the management of the private sector, which may have a positive effect on the quality of service provided as well as the fiscal budget. On the other hand, transfer of the project facilities will permit the host government to own the project revenues or to avoid having to pay for the project’s services/product.

The main interest of the project company is to be able to pay its lenders and to generate an economic return for its shareholders. By the end of the original term, the debt of the project should be paid in full and most of the fixed assets should have been fully depreciated, permitting higher profits from the revenues generated during any extension period . The project company, and its shareholders, in particular, will, therefore, have an economic incentive to extend the term of the project for as long as maintenance and operating costs allow profitable operations.

S. Effectiveness of Agreement.

Because the project agreement is generally executed prior to the occurrence of subsequent essential stages in the development of a project, such as financial closing, execution of certain transaction agreements or documents, and obtaining all permits and consents, its entering into force and effect should be conditional upon the fulfillment of certain conditions. The failure of any of such conditions generally leads to termination of the project agreement.

T. Secondary Developments.

The project company may be provided rights to explore project related opportunities such as the development of land adjacent to the project site to enhance project revenues, particularly in cases where projected revenues may otherwise be insufficient to support the financeability of a project. For example, in a motorway project, the project company would typically be granted the right to develop gas stations, rest stops and restaurant and lodging facilities on land adjacent to the motorway. The revenues from secondary developments, however, generally comprise only a minor fraction of total project revenues.

For certain projects, the main interest of the host government is to support the financeability of the project by providing additional sources of project revenue. The host government typically would use secondary developments as one of several ways in which certain types of projects may be supported. The host government may be able to negotiate a reduction in other support obligations in exchange for the granting of secondary development rights.

The main interest of the project company is to earn as much as possible profit from the project but also to support the financeability of the project. To facilitate finding parties to undertake the secondary developments, the project company will want to separate the secondary developments from the term of the project agreement, in effect giving the owners of the secondary developments s rights in perpetuity.

U. Lenders' Rights and Remedies.

- Right to security interest in project assets.

  Generally, the project company will be prohibited from transferring or assigning any of the project's assets, agreements or rights and obligations to third parties without the consent of the host government, but it is essential for the project company to have the power to give lenders a security interest in the assets, agreements and rights and obligations of the project for purposes of the project financing.

  The host government and project company must permit the lenders whatever security interest may be necessary for purposes of financing the project. The host government, preliminarily, should ensure that its legal framework is conducive to the effective enforcement of security interests in connection with debt obligations, without which project financing will not be possible.

- Step-in rights.

The host government typically is requested to grant lenders the right to "step into" the project company's rights and obligations in case of project company default under the project agreement and acknowledge the right of lenders to "step-in" for the project company in case of default under the financing agreements. The lenders, pursuant to their "step-in" rights, generally have an opportunity to cure any default under the project agreement and may substitute an entity of their choice for the project company (subject to meeting certain criteria related to performance capability).

The main interest of the host government is to ensure the technical and financial capability of any substituted entity to carry out the terms and conditions of the project agreements. Generally, the host government should have an approval right over any substituted entity.

The main interest of the lenders is to maintain control of the project company in case of project company default. To this end, the lenders typically request broad latitude in substituting an entity of their choice.

V. Applicable Law.

The governing law of the project agreement is typically the law of the host country.

The organizational documents of the project company would typically be governed by local law, as the special purpose company typically is a local company. Other project agreements may be subject to laws of different countries. Usually, the financing documents are governed by either New York or English law. However, in countries having substantial, long-term experience with concessions and BOT-related issues, particularly in most spanish- and french-speaking countries, it may be advisable for certain ancillary agreements related to the project agreement, including certain financing documents, to be governed by the law of the host country in order to facilitate a more coherent and workable jurisprudence with respect to the project.

W. Dispute Resolution.

Dispute resolution typically involves arbitration in a neutral jurisdiction pursuant to international arbitration standards and procedures, e.g., UNCITRAL, the Arbitration Institute of the Stockholm Chamber of Commerce, ICSID or ICC. English is generally the language of international arbitration.

X. Transfer of Project Facilities to Host Government.

For BOT projects, the project agreement will set forth the conditions of transfer of the project facilities to the host government at the end of the project term. The project company typically will be required to provide a special training program for government personnel prior to transfer of the facilities and to warrant a certain level of performance upon transfer, with liquidated damages payable in the event of substandard performance.

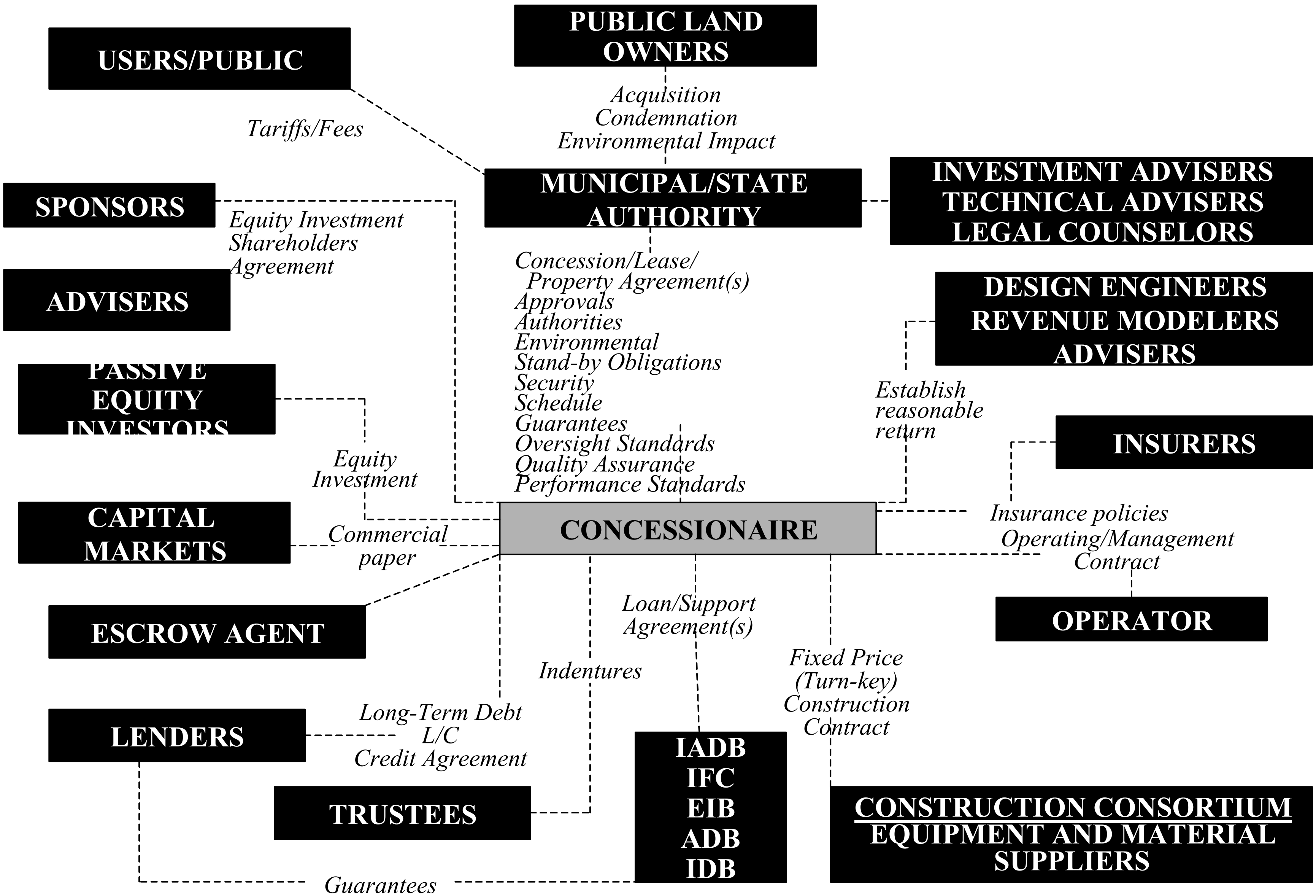
The main interest of the host government is to receive the project facilities in good performance condition and to have trained personnel ready to operate the facilities upon transfer.

The main interest of the project company is to exit the project smoothly without any liabilities for activities subsequent to the date of transfer.

VIII. Conclusion.

This Platform has attempted to provide a summary examination of certain important issues related to the main project agreement in connection with a PPP, elaborating such issues and discussing the respective interests of the public and private sectors. The intention is that this Platform will become a springboard for the effective training and improved knowledge of the government officials who are to be responsible for undertaking the burden of protecting the public interest in connection with negotiating PPPs on behalf of the government, thereby facilitating the implementation of PPPs by ultimately making such government officials more comfortable with PPPs, generally, and with the individual issues, specifically.

TYPICAL BOT PROJECT STRUCTURE



BOT: Build, Operate Transfer
Non- or Limited Recourse: Lenders' recourse is limited to the Project Company and its assets, including those real estate, equipment, contractual rights, bonds, insurance and government guarantees the Project Company has been able to obtain.

ANNEX A

Sample Risk Allocation Matrix

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Construction Period				
Cost Overrun	Within Construction Consortium Control	Included in Fixed Price Lump Sum Contract	No Effect	No Effect
	Outside Construction Consortium Control:			
	- Insured event	Proceeds of insurance policy including business interruption insurance	Draw on standby finance if insurance policy exhausted; Debt cover factors reduced if standby debt used	Return eroded by servicing of standby finance
	-Uninsured force majeure	Draw on standby finance	Debt cover factors reduced if standby debt used	Return eroded by servicing of standby finance
	- Ground conditions	Draw on standby finance	Debt cover factors reduced if standby debt used	Return eroded by servicing of standby finance
	- Owner variation orders	Draw on standby finance and limit scope of variations by Owner	Debt cover factors reduced if standby debt used	Return eroded by servicing of standby finance
	- Changes of law, delays in obtaining approvals or permits, increased taxes	Standby finance drawn pending tariff adjustment	Debt covers factors reduced if standby debt used	Return might be reduced because of timing effects

ANNEX B

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Delay in Completion	Within Construction Consortium Control	Penalties on a daily basis. (Sufficient to cover interest due to Lenders and fixed operating costs)	Debt cover factors reduced, if standby debt drawn	No effect (except loss of opportunity to earn bonuses) unless penalties fully spent. Use of standby finance for further costs will erode return
	Insured Force Majeure	Proceeds from business interruption insurance policy	Standby finance drawn if insurance policy exhausted; debt cover factors reduced if standby debt finance used	To extent ability to pay dividends is postponed, return eroded
	Ground Conditions	Draw on standby finances	Debt cover factors reduced if standby debt finance used	Return eroded by servicing of standby finance
Failure of Plant to meet Performance Specifications at Completion Tests as a result of fault by Construction Consortium	Capacity shortfall	Penalties payable by Construction Consortium supplemented by insurance	No effect	Return reduced if penalties from Construction Consortium exhausted
	Heat rate shortfalls	Penalties from Construction Consortium	Debt cover factors reduced. If Construction Consortium fails to remedy defect, credit risk on Construction Consortium	Return reduced by cost of additional residual fuel oil less penalty receipts

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Operating Costs Overrun	Costs exceed original estimates, not insurance or Force Majeure event	Standby finance drawn	Debt cover factors reduced if standby debt used	Return reduced by servicing of standby finance
	Insurance costs exceed original estimates	Standby finance drawn pending Tariff adjustment	Debt cover factors slightly reduced depending on timing effect	No effect
Increased Financing Costs	Interest rate increase	Standby finance drawn pending Tariff reopener	Debt cover factors slightly reduced depending on timing effect	No effect
	Adverse exchange rate change	Standby finance drawn pending tariff reopener	Debt cover factors slightly reduced depending on timing effect	No effect
	Adverse exchange in terms of finance	Standby finance drawn pending tariff reopener	Debt cover factors slightly reduced depending on timing effect	No effect

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Government	Minor changes in tax, law, customs, legal requirements, environmental standards	Tariff adjustment (if during construction period, standby finance drawn)	Standby finance could be required. No effect on Debt Service Cover Factor	No effect
	Expropriation, nationalization, consents withdrawn, interference causing severe prejudice	Owner entitled to terminate as Government default	If owner terminates, loan repaid or assumed as compensation	If Government defaults and owner terminates, compensation paid for termination
	Fundamental breach by the Government, under agreements	Owner entitled to terminate as Government default	If owner terminates, loan repaid or assumed as Compensation	If Government defaults and owner terminates, compensation paid for termination
OPERATION PERIOD				
Operating Costs Overrun	As a result of changes in regulations	Tariff adjustment	No effect	No effect
	At Owner's request	No adjustment to Tariff	Debt cover factors reduced	Return reduced
	As a result of failure by the operator	No adjustment to Tariff. Penalties payable by the operator	Debt cover factors reduced if penalties exhausted	Return reduced if penalties exhausted
Inflation, Adverse Changes in Cost of Finance, Exchange or Interest Rate Rates		Tariff adjusted by indices. Small possibility that movements in indices do not exactly match changes in actual costs	Debt cover factors could be reduced/increased	Possibility of erosion/increase in return

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Foreign Exchange Non-Availability/Non-Convertibility		Government guarantees availability of foreign exchange. If Government defaults, Owner can terminate	Loan repaid or assumed as Compensation	No effect (except loss of opportunity to earn bonuses) if Government pays under guarantee. If Government defaults under guarantee and Owner terminates Compensation paid for termination
Failure to Make Available Sufficient Foreign Exchange	Government default	Owner can terminate	If Owner terminates, loan is repaid or assumed as Compensation	compensation paid for termination
Failure of purchaser of power (State owned utility) to Perform Obligations		Government guarantees performance. If Government defaults under guarantee, Owner can terminate	No effect if Government pays under guarantee. If Government defaults under guarantee and Owner terminates, loan repaid or assumed as Compensation	No effect (except loss of opportunity to earn bonuses) if Government pays under guarantee. if Government defaults under guarantee and Owner terminates, Compensation paid for termination
Forced Outage/De-Rate or Temporary Shortfall in Capacity, Deterioration in Heat Rate	Owner's fault	Penalties payable by Owner	If penalties completely erode shareholders returns, possibility of insufficient cash. Debt service Escrow Account to be drawn down	Any penalty paid will erode return for investors

RISK MITIGATION ANALYSIS				
RISK	**REASON**	**REMEDY**	**CONSEQUENCES FOR LENDERS**	**CONSEQUENCES FOR INVESTORS**
Forced Outage or Temporary Shortfall in Capacity	Purchaser or electricity's fault	Capacity Purchase Price payable anyway	No effect	No effect
	Force majeure event	Capacity Purchase Price paid anyway	Government guarantees default by Purchaser. If Government defaults, Owner terminates and loan repaid or assumed as Compensation	Loss of opportunities to earn bonuses. If Government defaults, Owner can terminate. Compensation for termination paid by Government
Increased Fuel Costs (not arising from higher Heat Rate deterioration than Base Case)	Increase in price of RFO	Tariff adjustment	No effect	No effect
Boiler Explosion	Insured event	Insurance proceeds for physical reinstatement and business interruption cover for debt service costs	No effect unless insurance policy exhausted and standby debt finance used	Reduction in return if insurance policy exhausted
Failure of the Operator to Perform Obligations	The Operator's breach of Operations and Maintenance Agreement	Penalties payable by the Operator	Debt cover factors reduced if the Operator's penalties exhausted and standby debt finance used	Return reduced
Environmental Incidents Caused by the Operator	The Operator's breach of Operations and Maintenance Agreement	Indemnity from the Operator	Debt cover factors reduced if the Operator's penalties exhausted and standby debt finance used	Return reduced