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LEGAL PRACTITIONERS

PPP Bill:
The PPP Agreement

Introduction

Our last three articles in the series discussed the different procurement methods proposed under the PPP Bill. In this article, we analyse the PPP or concession agreement entered into when a PPP project is awarded to a developer. The PPP agreement governs the relationship between the contracting authority and the developer, setting the rights and obligations of each party and allocates the risk to be taken by each party. We examine the factors to consider while negotiating a PPP agreement, as well as the framework for PPP agreements envisioned in the PPP Bill.

Contents of a PPP Agreement

The PPP Bill establishes the framework for what should be contained in a PPP agreement. The PPP Bill allows parties to incorporate whatever they deem acceptable and relevant for their PPP agreement. However, parties to a PPP agreement should ensure that the following major issues are addressed:

(i) remedies in the event of default by either party;

(ii) rights of contracting authority to monitor the developer's work;

(iii) limitation of liability or force majeure;

(iv) change in law;

(v) insurance;

(vi) dispute resolution mechanisms;

(vii) treatment of confidential information;

(viii) termination and step-in or takeover of project; and

(ix) compensation for default or termination and the compensation calculation methods.

Duration of a PPP Agreement

The subject matter of the PPP project is critical in determining the duration and contents of a PPP agreement. PPP agreements for capital-intensive projects such as highways and airports would often be longer than those for less capital-intensive projects such as schools. The PPP Bill requires contracting authorities to take the following elements into account when deciding the duration or term of a PPP agreement:

(i) the lifespan of technology to be utilised by the project;

(ii) the economic life of the infrastructure and assets to be provided; and

(iii) the period required to recover investments.

A PPP agreement with a longer term or for a longer duration is required for a project whose technology and infrastructure have a lengthy lifespan and requires more time to recoup the investment and earn a profit.

Ownership of assets and land

From a developer's perspective, asset ownership and access to the land on which a project is being created are significant factors of the success of a PPP project. The PPP agreement should specify which assets belong to the developer and which belong to the contracting authority. A PPP agreement should therefore address the following in relation to the project assets:

(i) which assets the concessionaire will be required to return or transfer to the contracting authority at termination of the PPP agreement;

(ii) which assets a concessionaire may purchase from the contracting authority; and

(iii) which assets a concessionaire may dispose of or sale at termination of the PPP agreement.

To ensure availability of land for project development, the Government can compulsorily acquire any land for purposes of a PPP project, subject to paying compensation to the landowner in accordance with the Constitution and Lands Acquisition Act.

Charging and collection of user fees from the public/contracting authority

The major consideration for private sector involvement in PPPs is the recovery of investment and making a profit. The concessionaire is granted the power to charge and collect a levy for the infrastructure or service provided under the PPP agreement. Depending on the nature of the PPP project, the contracting authority may pay fees to the concessionaire in lieu of or in addition to the concessionaire charges user fees or levies to the public.

Creation of security of PPP assets and protection for lenders

To secure financing for a project, a concessionaire has the right to charge or create security over the PPP project in favour of the lenders. Lenders would require a security package that includes an assignment of rights under the PPP agreement, performance bonds, shareholder guarantees or a combination of some or all of the security options.

A PPP project would typically be project financed and lenders would need to assess the viability and creditworthiness of the project and whether the revenues generated would be sufficient to service the loan. The key characteristics of project finance transactions, which would also apply to a PPP project are as follows:

(i) repayments depend largely on revenues generated by the project;

(ii) financing is based on cash-flow generation rather than the high value assets; and

(iii) lenders have limited or no recourse to the sponsors or commercial parties associated with the project for debt repayment and servicing.

Lenders for a PPP project would therefore need to assess the commercial and legal risks that could affect the ability of a project to raise revenues for debt repayment.

Assignment of PPP agreement and change in control

The right to assign the PPP agreement and the clauses on change in control of the concessionaire are inextricably related to the concessionaire's ability to offer security to lenders. If the security package available to lenders includes a share charge over the concessionaire's shares, then the lenders would take control of the in an enforcement of security.

The PPP agreement specifies the criteria under which a contracting authority may consent to a concessionaire's rights being assigned. The criteria includes whether the new concessionaire accepts all of the duties under the PPP agreement and whether there is evidence of financial and technical capability on the part of the proposed new concessionaire to implement the project. The PPP Bill also expects the PPP agreement to specify the circumstances under which a change in control of the developer or concessionaire is permissible.

The PPP Bill recognises the rights of lenders by making provision for a lender and concessionaire to agree to a substitution of a concessionaire with another developer that would take over any existing obligations from the concessionaire in the event of a material default or other event that would otherwise justify terminating the PPP agreement.

Amendment of PPP agreement

A PPP agreement may be amended to offer equitable remuneration to a concessionaire where the cost of performing the PPP project has significantly increased or the value received has significantly decreased compared to what stakeholders initially anticipated as a result of either:

(i) changes in economic or financial conditions; or

(ii) legislative changes that are not directly related to the project or the concessionaire's services.

To amend a PPP agreement on the basis of economic or legislative changes, the changes should:

(i) have occurred during the performance of the PPP agreement. This means that if the changes occur during the negotiation phase of the PPP agreement, the preferred bidder should ensure that these changes are addressed before signing the agreement;

(ii) be beyond the control of the concessionaire; and

(iii) be of such nature that the concessionaire could not reasonably have;

 (a) been expected to take them into account when the PPP agreement was being negotiated; or

 (b) avoided or overcome the consequences of such changes.

A PPP agreement can also be amended if an amendment would ensure the following:

(i) continued value for money;

(ii) continued appropriate risk allocation; and

(iii) continued environmental protection and preservation.

An amendment to a PPP agreement takes effect only after approval by the PPP Council.

Takeover of Project

The PPP Bill makes provision for the takeover of PPP projects by contracting authorities. A takeover would be required to ensure either of:

(i) effective and uninterrupted delivery of a service; or

(ii) timely completion of a project in the event of a material default by the concessionaire and failure to take remedial measures within a reasonable time.

If a project is taken over by a contracting authority, the contracting authority would be authorised to do any of the following:

(i) collect user fees and pay the revenues that are subject to a lien (or charge) to satisfy any obligations;

(ii) develop and operate the project and comply with any existing contracts relating to the project;

(iii) solicit proposals for the construction, maintenance or operation of the project, as the case may be. Consideration for re-imbursement of the original concessionaire would be given if the project is awarded to another bidder, the project reaches financial close and if the development costs were borne by the concessionaire. A developer negotiating a PPP agreement should ensure that issues of compensation are set out in clear terms to avoid disputes should the project be taken over by a contracting authority.

Project winding up and hand-back

In addition to addressing compensation in the case of a takeover, parties should ensure that the following matters related to project winding up or hand-back are included in the PPP agreement:

(i) compensation for the transfer of assets from the concessionaire to contracting authority or new concessionaire;

(ii) transfer of technologies for the operation of the project;

(iii) training of the contracting authority's personnel in the operation of the project;

(iv) continued support for a reasonable period following project transition; and

(v) establishment of contingency fund for maintenance requirements after transfer of project to a contracting authority.

The PPP Bill also aims to promote and empower local subcontractors by mandating concessionaires to subcontract at least ten percent of all works to Zambian contractors and suppliers. Whether or not this requirement is recognised in a PPP agreement, a concessionaire would be expected to comply as it would be a mandatory legal obligation. In the up-coming series, we consider the provisions of the PPP Bill in the context of PPPs for SMEs and promotion of local contractors.

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