Public Private Partnerships

Osgoode Certificate in Construction Law
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Outline

1. Different P3 Models
2. Typical DBFM Transaction Structure
3. Analysis of Risk from a Lender's Perspective, & Ways to Mitigate These Risks
4. Special Issues for Contractors: Things to be Aware of, & How P3s Differ from CCDC Deals

What is a P3?

1. Use of private capital for public assets
2. Clear output specifications focus
3. Design and operation innovation

Why use a P3?

- Value for money
- On time and on budget
- Investment in asset maintenance
- Transfer of risk

Build-Finance

- Private entity responsible for financing and construction
- Developer secures sufficient financing and works with contractor to arrive at viable construction price and put forward competitive bid
- Public entity pays and takes ownership after construction certified as complete
- A P3 with training wheels

Design-Build-Maintain

- Private entity responsible for design and construction
- Public entity takes ownership after construction complete
- Private entity continues to maintain the facility
    - Ongoing Maintenance Agreement

Design-Build-Finance-Maintain

- In addition to obligations under DBM, private sector also responsible for financing

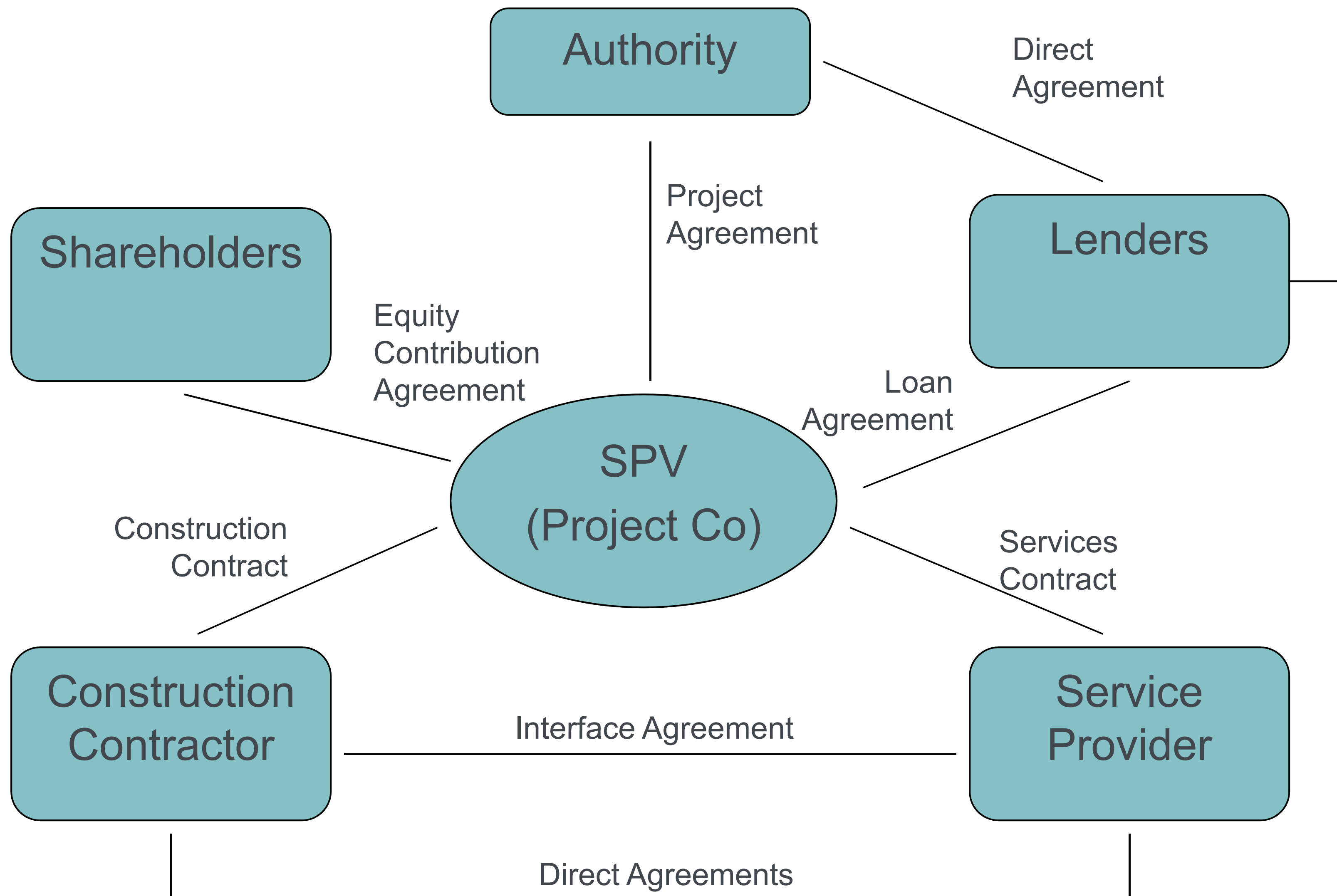
Design-Build-Finance-Operate (Maintain)

- Private entity responsible for design and construction
- Public entity takes ownership after construction complete
- Private entity continues to both maintain and operate the facility
  - Obligation to operate lasts for duration of concession period – often 30 years +
- Ownership
  - May remain with the public
  - Private entity may own with ownership reverting to the public after the agreement expires

Concession

- In addition to obligations under the DBFO model, private entity also takes on usage risk

Typical DBFM Transaction Structure



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Analysis of Risk from a Lender's Perspective

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Ways to Mitigate these Risks

Structural Risk

- What risks does Project Co. bear?
- Which risks are not passed down to a third party?

- Objective: identify which risks are borne only by Project Entity (if any) and which are borne/mitigated via third party support

- Actions: perform detailed analyses of:
  - Project Agreements & Related Contracts
  - Entity considerations
  - Tax considerations
  - Insurance considerations
  - Third Party support

Project Party Risk

Equity Providers

- How much are they contributing?
  - Actual $
  - Debt to equity ratio
- What financial resources are possessed and available?
- How committed are they?

- Actions:
  - Review/analyze financial statements
  - Review/analyze ability to deal with reputational risk

Construction Contractor

- What financial resources available? Parent Co. support?
- Limitation of liability?
- Third party support?
  - Bonding & subguard
  - Reserves
- Liquidated damages
- Bid price/contingencies
- Technical Advisor review
  - Contractor capabilities
  - Timeline
  - Construction price
  - Contingencies

Key Construction Contract Terms

- Full design and construction risk pass down
- Fixed completion date
- Fixed price
- Liquidated damages
- Security for performance
  - Bands
  - Reserves
  - PCG's
  - 4C

Key Construction Contract Terms

- Limitation's on contractor termination rights
- EPR
- Large liability caps and exceptions
  - No insurance
  - Subcontractors
- No/few rights to claim time or money
- Sub-contractor review and sign-off

Service Provider

- Technically capable of performing?
- Financial resources available? Parent Co. support?
- Limitation of liability?
- Third party support?
  - Bonding & subguard
  - Reserves
- Lifecycle obligations
- Technical Advisor review
  - Contractor capabilities
  - Services price
  - Contingencies

Counterparty Risk

- Crown or a Crown agency?
- If not, is there Crown funding or Crown financial support?

Asset Risk

- If the asset is damaged or destroyed, who bears this risk?
  - Construction period
    - Insured risks
    - Uninsured risks
  - Operation period
    - Insured risks
    - Uninsured risks
- If completion of the asset is delayed, who bears the risk?

Payment Risk

- Payment mechanism
  - Likelihood of deduction
  - Magnitude of deduction

- Actions:
  - Ability of Service Provider to absorb deductions
  - Debt service coverage ratio
  - Equity Lock ratio
  - Tail

Special Issues for Contractors:

Things to be Aware Of

&

How P3s Differ from CCDC Deals

Back-to-Back Principle

- Obligations are passed down to contractors on terms identical to those under which they were initially allocated to the Project Co. in the Project Agreement
- Contractor will generally be limited to receiving what Project Co. receives

Equivalent Project Relief

- Contractors should be entitled to relief from the Project Co. under the drop-down agreements that is equivalent to the relief available to the Project Co under the Project Agreement
- Drop-down agreement should include comprehensive regime respecting pass-down of relief and benefits available under Project Agreement
- Most Project Agreements will include:
  - Supervening event provisions
  - Indemnification of Project Co. by public sector entity in certain circumstances
  - Compensation on termination
  - Various provisions that make benefits available to Project Co.

Warranty Periods

- Notion of "owner" is complicated in P3 situations
  - Many parties have ownership-type interests
  - Must determine to whom warranty obligations are owed
- Project Agreements contain implied or express requirement that all works meet technical requirements throughout project term
- Project Co. not typically entitled to relief where deficiencies:
  - Need to be repaired during the project term, or
  - Create performance failures during the operational term
- In general, contractor is obligated to Project Co. in the first instance
- Lenders and public entity also have access to Project Co.'s warranty rights via direct agreements and collateral agreements

- Latent defects versus other defects
  - Latent defects: equity sponsor expectation is that contractor liability extends until the expiry of statutory limitation periods.
  - Other defects: Limited warranty period for defects similar to construction industry standards
- Project Co. gives perpetual warranty throughout the term
  - Term usually exceeds standard industry warranty periods
- Equity sponsors want to increase scope and duration of warranties to minimize stranded risk within Project Co.

Construction Liens

- Drop-down of “no encumbrances”
- Definition of “owner”
- Multiple sites

Liquidated Damages

- Where a delay is caused by a contractor, Project Co. and lenders expect to be made whole by contractor during delay
- Drop-down agreements contain obligation to pay *per diem* liquidated damages to Project Co. for delay
- Contractor may have to accept repayment timing risk on Authority delay
- Quantum determined based on a financial model
- Incentive for contractor to adhere to schedule
- Lenders often require additional security for liquidated damages obligations

Interface Issues

- Interface Agreements between Project Co. and contractors:
  - General obligation of cooperation
  - Specific obligations of cooperation
  - Site access regime
  - Project relief provisions regarding disputes between contractors
  - Liability for deductions and set-offs
  - Other provisions as desired by the parties

Indemnities and Liability Caps

- Typically go beyond construction industry practice
- Scope and substance: consistent with back-to-back principle
- Contractors will want carve-outs to remove exposure caused by actions of the Project Co. itself or third parties
- Project Agreements often limits liability to direct losses
  - Contractors will want to negotiate similar limits
- Obligation on Project Co. to pay breakage costs
  - Contractor will have to indemnify if they cause default
- Financial guarantee of debt obligations can affect bonding

Direct Agreements with Lenders

- To mitigate their risk, lenders enter into direct agreements, allowing them to intervene to prevent default termination, with:
  - The public entity
  - Each of the primary contractors
- Key components of a direct agreement:
  - Notice of default
  - Standstill period
  - Step-in rights
    - Upfront consents to assignment or novation
    - Step-out provisions
  - Ability to transfer project to a replacement project company

Questions?

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