



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

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

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

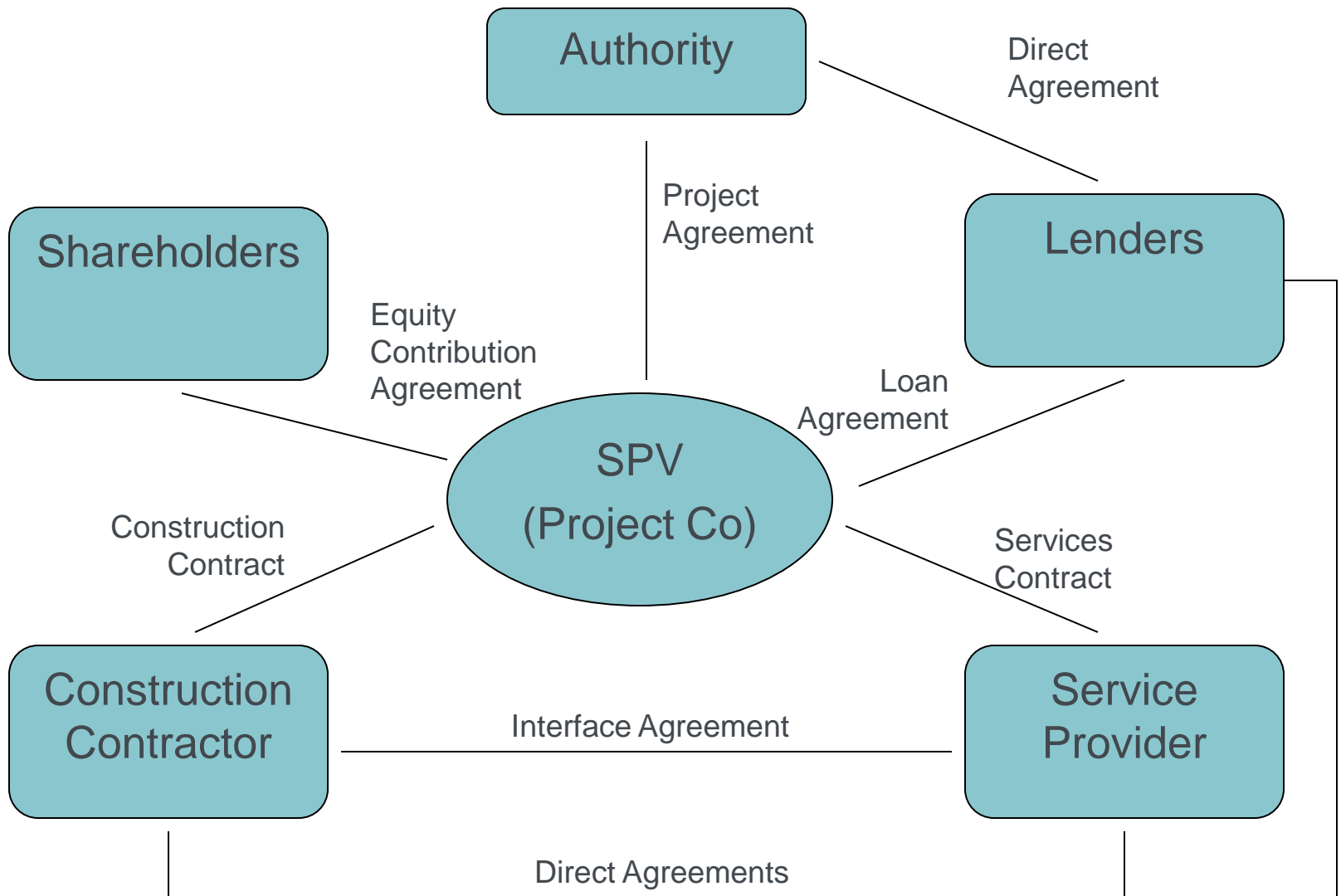
Design-Build-Finance-Operate

- Private entity responsible for design and construction
- Public entity takes ownership after construction complete
- Private entity continues to both maintain and operate the facility
 - Ongoing Maintenance Agreement
 - Obligation to operate lasts for duration of concession period – often 30 years +
- Ownership
 - May remain with the public (e.g.: long-term lease)
 - Private entity may own initially, with ownership reverting to the public after the agreement expires

Concession

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

Typical DBFM Transaction Structure



Analysis of Risk from a Lender's Perspective
&
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

- Technically capable of performing?
- What financial resources available? Parent Co. support?
- How committed are they? Will they walk away?
- Limitation of liability?
- Third party support?
 - Bonding & subguard
 - Reserves
- Bid price/contingencies

- Actions:
 - Review/analyze financial statements
 - Analyze availability of construction performance support
 - Technical Advisor review
 - Contractor capabilities
 - Timeline
 - Construction price
 - Contingencies

Service Provider

- Technically capable of performing?
- Financial resources available? Parent Co. support?
- How committed are they?
- Limitation of liability?
- Third party support?
 - Bonding & subguard
 - Reserves
- Lifecycle obligations

Counterparty Risk

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

- Actions:
 - Review/analyze financial statements
 - Review/analyze availability of performance support
 - Technical Advisor review
 - Contractor capabilities
 - Services price
 - Contingencies

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 on terms identical to those under which they were initially allocated to the Project Co. in the Project Agreement

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 or phases

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

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

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 Provincial delay
- Quantum determined based on a financial model
- Incentive for contractor to adhere to schedule
- Lenders often require additional security for liquidated damages obligations

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



Questions?

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