Alternative Delivery Symposium Outline

Ontario Road Builders' Association
2 December 2013

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Document #: 21540153

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

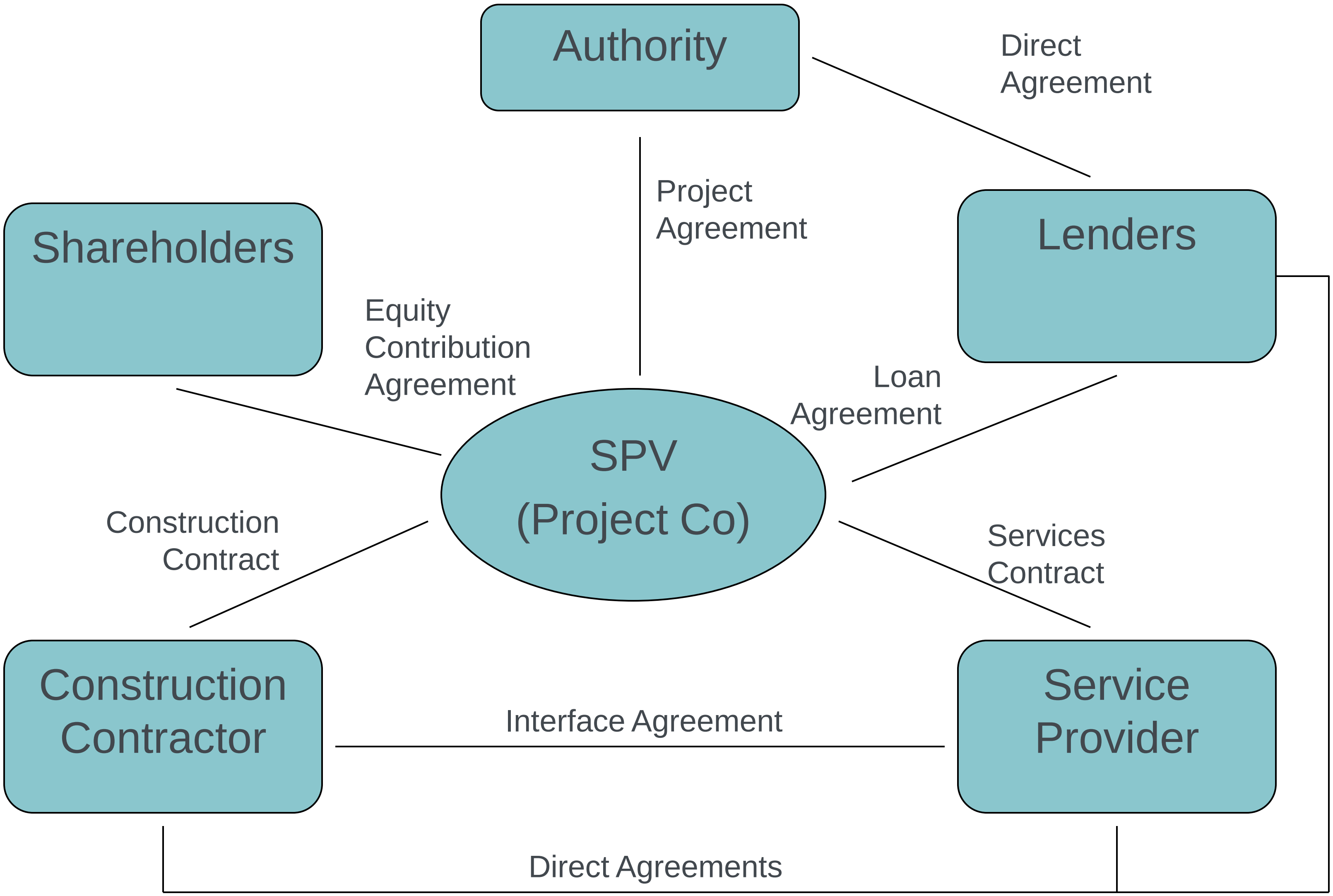
Design-Build-Finance-Operate

- 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



Risk Analysis

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Mitigation

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 (Construction / Operation)
  - Entity considerations
  - Tax considerations
  - Insurance considerations
  - Third Party support

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Project Party Risk

A. 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

B. 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

C. 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?

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?

Special Issues for Contractors:

Things to be Aware Of

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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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