NATIONAL TREASURY

PPP unit

STANDARDISED PUBLIC-PRIVATE PARTNERSHIP PROVISIONS

NATIONAL TREASURY

STANDARDISED PPP PROVISIONS

(“Standardisation”)

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In accordance with section 76(4)(g) of the Public Finance Management Act of 1999 (“PFMA”), the National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This Standardisation is issued by the National Treasury pursuant to such section of the PFMA as National Treasury PPP Practice Note Number 01 of 2004, and applies to departments, constitutional institutions, public entities listed or required to be listed in Schedules 3A, 3B, 3C and 3D to the PFMA and subsidiaries of such public entities.

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PREFACE

(A) Introduction

(A1) This Standardisation describes the key issues that are likely to arise in public private partnership ("**PPP**") projects regulated by the provisions of regulation 16 of the Treasury Regulations ("**Treasury Regulation 16**").[1] It prescribes how these key issues must be dealt with in a PPP agreement (as defined in Treasury Regulation 16) ("**PPP Agreement**") in a manner that achieves the requirements of "substantial risk transfer", "value for money" and "affordability", as these terms are defined or otherwise dealt with in Treasury Regulation 16.

(A2) Key issues that are not capable of standard treatment (either because of sector-specific requirements or because of specific circumstances affecting a particular PPP) are identified in this Standardisation but are not given detailed consideration. Institutions must seek to identify such issues during the feasibility study phase of a PPP, that is, in the phase preceding the issue of Treasury Approval: I (as described in Treasury Regulation 16) ("**TA:I**"), and bring them to the attention of the relevant Treasury (currently, the National Treasury) in the application for TA:I.[2]

(A3) The objectives of this Standardisation include the promotion of a common understanding of the technical, operational and financial risks that are typically encountered in PPPs, a common understanding of how such risks must be transferred or shared among the parties involved in the delivery of PPPs, a consistent approach to risk transfer, risk sharing and value for money across PPPs falling within the same sector, and a reduction of the time and cost of negotiation of the parties involved in a PPP.

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[1] Treasury Regulations for Departments, Trading Entities, Constitutional Institutions and Public Entities, published in GN 740 *GG* 23643 of 25 May 2002 (the "**Treasury Regulations**") issued in terms of the Public Finance Management Act, 1999 (the "**PFMA**"), as amended.

[2] Treasury Regulation 16.4.

(A4) It is important to note that this Standardisation (like Treasury Regulation 16) focuses on the appropriate risk profile of PPPs. It does not focus on whether PPPs are suitable mechanisms for service delivery (as opposed to "internal" mechanisms for service delivery traditionally used by the institutions that are subject to Treasury Regulation 16[3] ("**Institutions**")), nor does it focus on the identification of the types of PPPs that are suitable for pursuit by such Institutions. The responsibility for identifying whether a PPP is suitable for an Institution's strategic and operational needs and requirements lies with the Institution, since it is best placed to identify those needs and requirements.

(A5) As stated above, sector-specific issues are not addressed in this Standardisation. Accordingly, this Standardisation is no substitute for a comprehensive consideration of all issues that may be relevant to a PPP. Rather, its aim is to assist in the conduct of such consideration. The National Treasury intends to prepare, in due course, sector-specific standardisations, which will complement this Standardisation.

(A6) This Standardisation must be used in conjunction with the National Treasury PPP Practice Notes published as modules in the *National Treasury PPP Manual* from time to time. These are:

(a) Module 1: South African Regulations for PPPs;

(b) Module 2: Code of Good Practice for BEE in PPPs;

(c) Module 3: PPP Inception;

(d) Module 4: PPP Feasibility Study;

(e) Module 5: PPP Procurement;

(f) Module 6: Managing the PPP Agreement;

(g) Module 7: Auditing PPPs; and

(h) Module 8: Accounting Treatment for PPPs.

[3] These Institutions comprise constitutional institutions, national and provincial departments and those national and provincial government enterprises and national and provincial public entities that are listed from time to time in Schedule 3 to the PFMA unless specifically exempted pursuant to section 92 of the PFMA or Treasury Regulation 16.10.

(B) Assumptions

(B1) Given the complexities associated with trying to achieve these objectives across a wide range of diverse sectors, each with different funding requirements for service delivery, a number of assumptions have been made in this Standardisation. These assumptions are that:

(B1.1) the "Private Party" (as defined in Treasury Regulation 16, and referred to in this Standardisation as the "**Private Party**") to a PPP Agreement is a special-purpose vehicle ("**SPV**") incorporated in the Republic of South Africa in accordance with applicable law as a private limited liability company for the sole purpose of exercising its rights and performing its obligations under the PPP Agreement;[4]

(B1.2) the project involves the provision of public infrastructure and related services and this entails an initial design and construction phase and a later operational phase during which the required services will be delivered to the Institution;

(B1.3) the project deliverables (collectively all the rights and obligations of the Private Party in relation to both phases of the project) will be subcontracted down by the Private Party to others (these subcontractors usually being the shareholders of the Private Party or parties related to them (that is, affiliated or associated companies)). These subcontracts will include a construction subcontract and an operations subcontract;

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[4] The main justifications for ring-fencing the business of a project in such an SPV are, first, to limit an Institution's exposure to the risks of insolvency of the shareholders of the Private Party, secondly, to insulate a project from the risks associated with any other business (that is, non-project business) that may be carried on by the Private Party, thirdly, to ring-fence the cash flows and expenditure of the project from that of any other non-project business, fourthly, to facilitate the creation and spread of empowerment equity, fifthly, to simplify the monitoring of the performance of the project and, lastly, to simplify any handback of the assets of the project at the end of the term of the project.

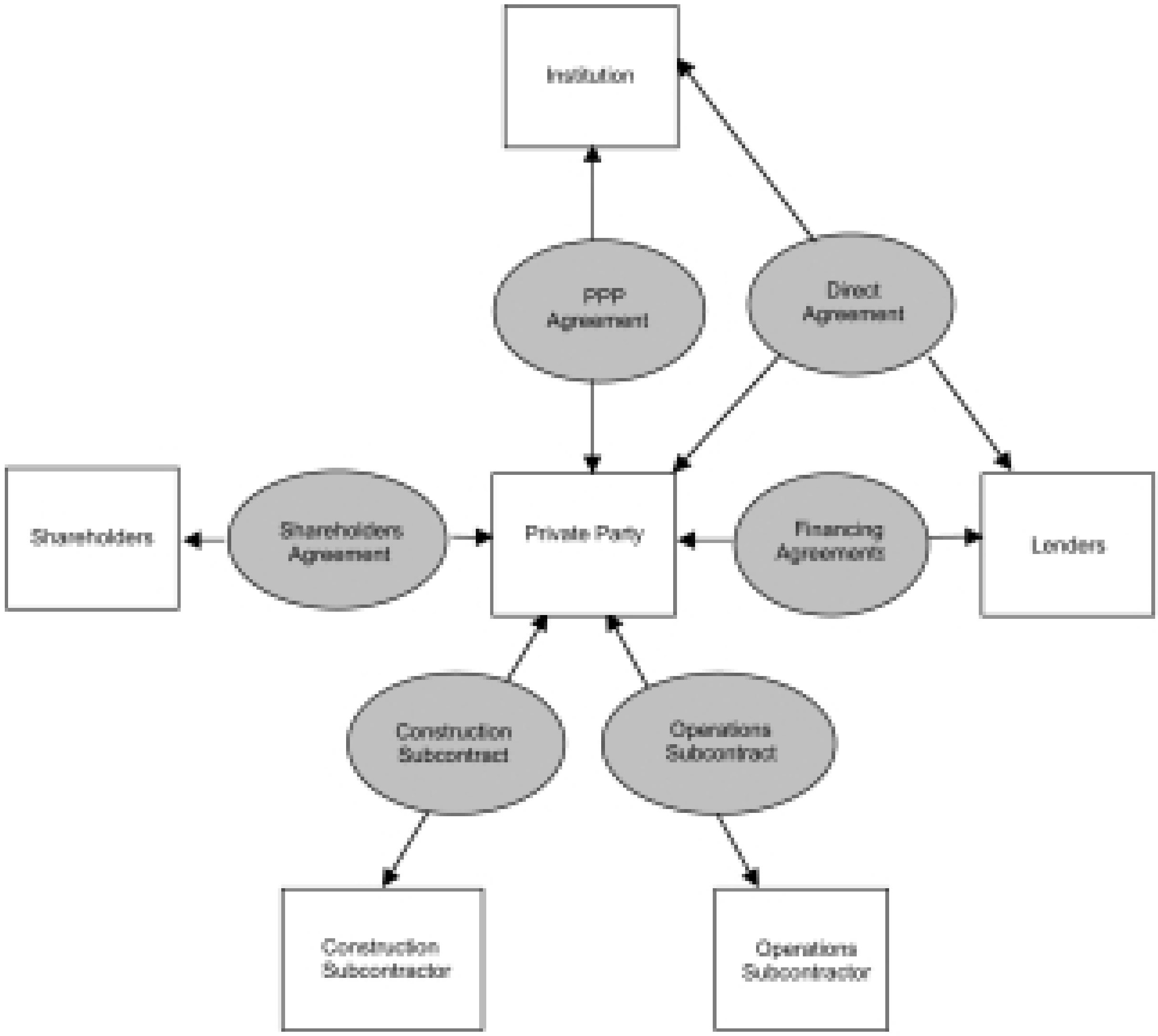
As part of the Institution's due diligence, the Institution should request and review all documents required in terms of the Companies Act, 1973 for the incorporation of the Private Party as a private limited liability company including its memorandum and articles of association to ensure that all tender requirements regarding the objects, capacity, powers and capital structure of the Private Party have been complied with.

(B1.4) the Private Party will receive a benefit for delivering the services to the Institution in the form of "unitary" payments made by the Institution from time to time. A unitary payment is one where the payment is not made up of separate amounts for the various specific inputs that comprise the services, but is a single or whole payment for the full service requirement; and

(B1.5) substantial funding for the project is to be provided by limited-recourse debt to be made available by lenders (other than the shareholders or related parties of the Private Party) who will look primarily to the cash flows generated from the project (that is, the unitary payments to be made by the Institution for the delivery of the services) to service that debt.[5] Since the cash flows generated in a project will depend on the sustained delivery by the Private Party of the agreed services at the prescribed performance levels, poor performance by the Private Party will put the servicing of such debt at risk. These lenders will be able to mitigate such risk in part through step-in and substitution mechanisms provided for in terms of a direct agreement between them and the Institution.

[5] The Lenders typically also seek security from the shareholders of the Private Party or their parent companies, though such security may not be sufficient. In such event, they may also take security over those assets acquired by the Private Party that the Institution will not require at the end of the term of the project. These assets must be clearly identified by the Institution (taking into account value for money considerations) and communicated to the bidders at the bid phase of the project. See Part G:36 (*Project Assets: Security Over Project Assets*) and Module 5: PPP Procurement.

(B2) The basic contractual arrangements posed by the funding structure referred to in these assumptions are reflected in the following organogram:



(B3) The above assumptions reflect the basic funding structure for projects that are funded with limited-recourse debt, that is, on a project finance basis, and are typical for projects that are highly capital intensive and therefore require funding sources with relatively low costs (compared to pure equity funding). A project finance funding structure, however, will not be appropriate for all PPPs. A different funding structure may be more appropriate in projects which are not highly capital intensive. These projects may also be funded on the balance sheet of Private Parties that are existing companies (so-called "corporate finance") or through capital contributions by Institutions and/or other public-sector bodies.

(B4) An Institution should consider all alternatives to limited-recourse debt if they achieve substantial risk transfer, meet the value for money[6] and affordability levels set for its proposed project and, in addition, if they are able to accommodate mechanisms for the ring-fencing of all cash flows from the proposed project.[7] A key feature of this risk transfer requirement is that third party funders must assume some performance risk.

(C) Other Funding Structures

(C1) *Corporate Finance*

(C1.1) In a corporate finance structure, a Private Party arranges the funding necessary to meet the capital and other expenditure requirements of a project from its own balance sheet resources (or those of its shareholders and related parties). In such a structure there is no need for an SPV to ring-fence the project or for a direct agreement between the Institution and any third party funders. This type of structure can be used across all sectors in projects with capital requirements below the levels at which project finance becomes cost effective.

(C1.2) Here, third party funders are taking credit risk on the Private Party itself, as opposed to taking credit risk on the delivery of the services by the Private Party at sustained performance levels. Institutions will therefore need to conduct a comprehensive due diligence into the financial strength and creditworthiness of any bidder proposing a corporate finance structure. Having regard to the outcome of such due diligence, the required value for money and affordability levels set for the project and any capital contributions to be provided by the public-sector, an

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6 Institutions should note that "value for money" (as defined and used in Treasury Regulation 16) does not equate to the cheapest price. Risk transfer is always a fundamental consideration in the assessment of the value for money benefits of a bid. A very low bid price might well be attractive to the Institution because of its apparent affordability, however, the bid may offer low risk transfer and, therefore, not yield better value for money. Institutions should also bear in mind that apart from cost, price and risk transfer, quality and quantity are also fundamental considerations in assessing value for money.

7 The ring-fencing of the cash flows in a project with a non-project finance funding structure is necessary to enable the Institution to monitor the cash flow of that project. This is essential in the case of revenue-generating projects.

Institution may also need to consider whether or not it should require the Private Party to furnish it with any security (such as on-demand performance bonds to secure the performance obligations of the Private Party and letters of credit and/or parent company guarantees to secure the repayment of the capital contributions by the public-sector) or to maintain any credit ratings for the duration of the PPP Agreement.

(C2) *Capital Contribution by the Institution*

(C2.1) The Institution and/or other public-sector bodies may contribute a substantial portion of the capital required for a project. Such capital may be contributed as grants, although this is not always possible given the budgetary and regulatory framework applicable to the Institution or other public-sector bodies. It is essential that the budgetary and regulatory requirements applicable to the Institution or public-sector bodies be meticulously complied with before any commitment is made to provide capital funding of this sort. The tax implications of this funding structure must be carefully considered, particularly in relation to value-added tax ("**VAT**"). Legal restrictions on the holding of shares by government entities in companies in which the private sector also holds shares, as well as the provisions of chapter 8 of the PFMA, must also be borne in mind when deciding how to structure these capital contributions.

(C2.2) The provision of these capital contributions by Institutions and/or other public-sector bodies obviously affects the allocation of risk. This funding structure should only be used where the funds concerned are to be applied by the Private Party in the provision of assets (movable and/or immovable) for the project that will either immediately or on termination of the PPP Agreement become the property of the Institution or other public-sector body. How this will be achieved must therefore also be carefully analysed and provided for. Again, the VAT and other tax consequences of any such transfer must be taken into account. The assets so provided can clearly never be available to secure obligations of the Private Party to any third party creditors (including its funders). These assets must also be fully "ring-fenced" so that even if they are not made available formally as security to third party creditors, they should also not be capable of being attached by such creditors in any circumstances. The use of this funding mechanism must not result in inappropriate risk being retained by, or passed back to, the Institution or other public-sector bodies.

(D) Types of PPPs

This Standardisation applies only to those types of PPPs which are subject to Treasury Regulation 16. The PPP definition in Treasury Regulation 16 distinguishes between two[8] basic kinds of PPP, one involving the performance by a Private Party of an "institutional function" and the other involving some form of "use of state property" by a Private Party for its own commercial purposes.[9]

(D1) *Performance of an Institutional Function*

(D1.1) As regards the first type of PPP, the concept of "institutional function" is defined broadly as a service, task, assignment or other function (or any part or component thereof) that an Institution performs in the public interest or on behalf of the public service generally, or any service, task, assignment or other function performed in support thereof. This may include any service, task, assignment or other function that is included in the functional areas of competence assigned to the Institution in terms of Schedule 4 or 5 to the *Constitution of the Republic of South Africa*, 1996 (the "**Constitution**"), or any other service, task, assignment or function assigned to an Institution by legislation. This Standardisation does not provide guidance as to whether or not a particular institutional function resides with any one institution, as opposed to another.[10] This must be determined on a project-by-project basis at the feasibility study phase of each proposed PPP.[11]

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8 A project may be a hybrid and involve both kinds of PPP.

9 The extension of the concept of PPPs to the "use of State property" was introduced in May 2002.

10 A key indicator of the competency of the Institution to perform an institutional function is the allocation of the budget for that function to the Institution since the budgetary allocation follows function.

11 See Module 4: PPP Feasibility Study.

(D1.2) Furthermore, Institutions should bear in mind that even though the phrases "in the public interest" and "on behalf of the public service generally" are broad and could conceivably encompass any function whatsoever that is performed by an Institution (since, in a sense, everything done or to be done by any entity in the public administration is or must be done in the public interest or on behalf of the public service), nevertheless, the broadness of these phrases and the fact that Treasury Regulation 16 does not expressly exclude any type of institutional function from being performed by a Private Party pursuant to a PPP Agreement does *not* mean that an Institution may outsource *any* of its institutional functions to the private sector. This is because certain institutional functions are reserved under applicable law for performance only by the Institutions concerned and may not be outsourced to the private sector. This Standardisation does not provide guidance regarding the lawfulness of any outsourcing proposed by an Institution.

(D1.3) The responsibility for determining whether an institutional function resides with an Institution and whether that institutional function may be outsourced to the private sector pursuant to a PPP lies with the Institution proposing the PPP. In this regard, the Institution must take due cognisance of the requirements of its governing legislation and any other applicable law (not limited to Treasury Regulation 16). It should be noted that as part of the feasibility study included in its application for TA:I, the Institution must obtain legal opinion on the extent to which a Private Party can legally perform the required institutional function in terms of a PPP Agreement.[12]

(D1.4) It should also be noted that there is nothing in the PFMA or the Treasury Regulations to indicate that PPPs may be used to limit an Institution's responsibilities in performing its institutional functions efficiently and in a manner which demonstrates its accountability for such performance, or that PPPs are the sole or preferred option for the performance by an

[12] Treasury Regulation 16.4.1.

Institution of its institutional functions. This means that, notwithstanding the delegation pursuant to a PPP Agreement of any institutional function by the Institution to a Private Party, the Institution remains accountable for the efficient delivery of such function.[13]

(D1.5) A PPP for the performance of an institutional function entails "*output*"-based procurement, pursuant to which an Institution procures the performance and delivery of an institutional function on its behalf by a Private Party where such performance and delivery are subject to specified "*outcomes*" or "*targets*" such as quality, efficiency and quantity. This is in contrast to "*input*"-based procurement where an institution is procuring goods, assets and/or services from a private sector party that will enable the institution itself to perform and deliver its institutional functions. In other words, PPPs exclude conventional procurement transactions such as the procurement of civil works construction, agreements for the supply of goods and agreements for the provision of services by the private sector not amounting to the performance of an institutional function. In these conventional procurement transactions, the institution performs its institutional functions while the private sector party's performance obligations in relation to any such institutional functions are purely input driven, that is, to supply the inputs required for the continued performance by such institution of its institutional functions. The significance of this distinction turns on the extent of the allocation of the risks associated with the procurement in question between the institution and the private sector party. In PPP procurement, the Institution seeks substantial transfer of the risks associated with the inputs used in the performance of the institutional function to the extent that such risk transfer achieves better value for money for the Institution;[14]

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13 Treasury Regulation 16.7.2 provides expressly that: "A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed in the public interest or on behalf of the public service."

14 Treasury Regulation 16.1.

whereas conventional procurement does not entail substantial risk transfer to the private sector and is not governed by Treasury Regulation 16.[15]

(D2) *Use of State Property*[16]

(D2.1) As regards the second type of PPP (that is, the "use of state property") the term "state property" is defined in Treasury Regulation 16, but "use" is not. "State property" is broadly defined as all movable and immovable property belonging to the state including intellectual property rights. In its broadest form, the term "use" in relation to property may include a variety of use forms recognised in our law including, without limitation, those arising under a contract of "lease" or a contract of "concession".[17]

(D2.2) While the definition of a PPP in Treasury Regulation 16 does not exclude or limit the types of use of state property that will be governed by Treasury Regulation 16 (provided such use meets the requirements of value for money and risk transfer), certain types of use are not regulated by Treasury Regulation 16 but rather by other provisions of the PFMA and the Treasury Regulations.[18] Since the legal consequences of the

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15 Treasury Regulation 16 does not apply to conventional procurement. At the national level, conventional procurement is governed by the State Tender Board Act, 1968 together with the new State Tender Board Regulations (See GN R1733 *GG* 25766 of 5 December 2003 (*Reg Gaz 7836*)), unless the accounting officer or accounting authority of the procuring institution elects to follow the procurement route provided for in the new Regulations in terms of the Public Finance Management Act, 1999: Framework for Supply Chain Management (See GN R1734 *GG* 25767 of 5 December 2003 (*Reg Gaz 7837*)) (the "**Supply Chain Management Regulations**"). At the provincial level, conventional procurement will be governed by provincial tender board legislation and, in the absence of such legislation, the Supply Chain Management Regulations.

In the case of provincial PPP procurement, provincial Institutions should note that some provincial tender board statutes effectively grant the provincial tender boards established pursuant thereto exclusive authority to undertake *all* procurements on behalf of provincial departments and provincial public entities, including PPP procurements. This is in conflict with Treasury Regulation 16, which confers exclusive authority on accounting officers and accounting authorities of provincial departments and provincial public entities to undertake their PPP procurements. Because the legal risks associated with this conflict might discourage the submission of bids in PPP procurements or have other negative consequences, any provincial Institution faced with such a conflict should not proceed with a PPP procurement unless appropriate action is taken to ensure that it is permitted to do so under the laws of its province.

16 In PPPs involving the use of state property for the Private Party's own commercial purposes and where the Private Party will not be performing an institutional function on behalf of the Institution, the risk transfer requirement may be even greater than that for PPPs involving the performance of an institutional function (for instance, all planning risks and environmental risks will be for the Private Party and the Institution will not share in these risks as provided for in this Standardisation). Accordingly, an Institution wishing to enter into such a PPP should not assume that any risks identified in this Standardisation as being allocated to Institutions should always be assumed by it in such a PPP and should undertake a thorough assessment of these risks in the specific context of such PPP.

17 For a discussion on the distinctions between leases and concessions, see Part D (*Project Site*).

18 For instance, Treasury Regulations 13.2 and 32.2 prohibit accounting officers of departments and constitutional institutions and accounting authorities of public entities from entering into a lease (defined as a contract conferring on the lessee the right to the use of any property, plant and equipment for a fixed period of time with a fixed schedule of payments to the lessor) on behalf of that department, institution or public entity, if that lease constitutes a "*finance lease*". This will be the case if, for instance, the lease is for *the economic life* of the asset even if title is not transferred, the lessor *transfers ownership* of the leased asset to the lessee at the end of the lease period, or the lessee has the *option to purchase the leased asset at a price which is expected to be lower than the fair value thereof at the date the option becomes exercisable* so that at the inception of the lease it is reasonably certain that the option will be exercised. In sum, a finance lease is a lease where the lessee assumes the risks and obligations arising from ownership, by contrast to an "*operating lease*" (defined in Treasury Regulation 1.1) where the lessor retains such risks and obligations. Finance leases are governed by chapter 8 of the PFMA and Treasury Regulations 13 and 32.2.

nature of various types of use vary substantially, legal advice should be sought regarding the type of legal arrangement that best fits the nature of the use rights that an Institution wishes to contract out to a Private Party in a PPP Agreement. This should be established at the feasibility study phase.[19] This Standardisation does not reflect a preference for any one use-type over another. Rather, this should be established on a project-by-project basis. Institutions should also bear in mind that a PPP will not limit an Institution's responsibility for ensuring that state property is not abused or neglected.[20]

(E) Implementation[21]

(E1) As stated in the Introduction, this Standardisation does not seek to prescribe a standardised approach to every issue arising in PPPs across all sectors and projects to the extent that any sector-specific requirements or project-specific circumstances justify specific treatment. This Standardisation expressly identifies circumstances where the approach taken in relation to an issue is not prescribed, but recommended or suggested (based on value for money considerations). In these circumstances, the Parties may deviate from the recommended or suggested approach to the extent that such deviation ensures value for money for the Institution.

(E2) In all circumstances where deviations from the standardised treatment of issues are not expressly permitted in this Standardisation, an Institution seeking to deviate from any such standardised treatment must identify any such deviations and explain its reasons for such deviations in its application to the relevant Treasury for Treasury Approval: IIA (as described in Treasury Regulation 16, and referred to herein as "**TA:IIA**"), which must be obtained before the proposed PPP Agreement is attached to the Request for Proposals ("**RFP**") for the procurement of that PPP and put out to tender.

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19 See Module 4: PPP Feasibility Study.

20 Treasury Regulation 16.7.3 imposes a responsibility on the accounting officer or accounting authority of an Institution to ensure that the PPP Agreement provides protections against the forfeiture, theft, loss, wastage and misuse of state property.

21 See Module 5: PPP Procurement.

(E3) This Standardisation also sets forth standard clauses and definitions that relate to those issues for which there ought to be standardised treatment (unless, in relation to any particular standard clause or definition, the contrary is expressly stated). These standard clauses and definitions should be included (where appropriate) in all PPP Agreements without any substantive amendment. An Institution that wishes to deviate from any of the standard clauses and definitions in the proposed PPP Agreement must identify these deviations and explain its reasons for them in its application for TA:IIA. This Standardisation does not set forth standard clauses and definitions for certain issues addressed herein. Where these issues arise in a PPP, the Institution should ensure that the proposed PPP Agreement submitted for TA:IIA includes clauses and definitions that cover these issues and that these clauses and definitions are consistent with the approach to these issues as prescribed herein, unless the Institution wishes to deviate from the prescribed approach and such deviations are identified and explained as described above.

(E4) Bidders who seek to deviate from the prescribed treatment of issues as set out in the RFP and the proposed PPP Agreement attached thereto should be required to clearly mark their proposed deviations on the proposed PPP Agreement and to explain in their bid documents their reasons for such deviations and the impact of such deviations on their bid prices.

(E5) Any substantive amendments to any standard clauses and definitions incorporated in a PPP Agreement for which TA:IIA or Treasury Approval III (as described in Treasury Regulation 16, and referred to herein as "**TA:III**") has already been granted will require written approval from the relevant Treasury.

(F) Timing

(F1) This issue of the Standardisation must be complied with by all Institutions in respect of any proposed PPP Agreement for which a TA:IIA has not yet been granted as at the date of issue hereof. Thus, in the case of any new PPP and any existing PPP for which only TA:I has been granted as at the date hereof, any proposed PPP Agreement relating to it must conform to this Standardisation save to the extent that a proposed deviation from this Standardisation has been notified to and approved by the relevant Treasury.

(F2) Any PPP Agreement which has been approved pursuant to a TA:IIA or TA:III granted by the relevant Treasury at any time before the date of issue of this Standardisation will not have to be amended in order to conform to this Standardisation. Any such PPP Agreement must continue to be dealt with by the relevant Institution in line with the terms and conditions of the TA:IIA or TA:III, as the case may be, and any other instruction or directive given by the relevant Treasury in respect of the PPP concerned.

(G) Terminology

Unless the context requires otherwise, all terms used in this Standardisation that are defined in the Treasury Regulations shall have the meanings as defined in the Treasury Regulations.

(H) Process and Acknowledgements

This issue of the Standardisation is the culmination of a lengthy, lively and interactive process started by the National Treasury in early 2002. The process, which has sought to be as inclusive as possible, was delegated by the National Treasury to a steering committee consisting of members of the National Treasury's PPP Unit, a Project Co-ordinator Levinsohn & Associates (Pty) Ltd, the principal drafters White & Case LLP and other professional consultants (the "**PPP Steering Committee**").

The process consisted of a series of consultations between:

(a) the PPP Steering Committee and a review group made up of representatives from the facilities management sector, the information technology sector, the legal sector, the financial services and banking sector, the construction sector and empowerment interest groups (the "**Review Group**"); and

(b) the PPP Steering Committee and the private sector.

The first draft of this Standardisation approved by the PPP Steering Committee was submitted to the Review Group for its review and comment in the last quarter of 2002. The PPP Steering Committee met with the Review Group to discuss the comments received.

Following these discussions, a further draft of this Standardisation was made available in the first quarter of 2003 to all national and provincial departments, public entities and constitutional institutions, for their review and comment. The PPP Steering Committee then met with the Review Group to consider these comments.

After this Review Group meeting, a further draft of this Standardisation was published in mid-2003 for review and comment by the private sector. Following the receipt by the PPP Steering Committee of comments from the private sector, a public hearing was held on 3 September 2003 at which the private sector was invited to present their comments to the PPP Steering Committee.

At the request of the private sector, several working groups were formed to focus on key issues highlighted at the public hearing. Working group meetings were held during October 2003, following which the PPP Steering Committee convened several times to discuss the issues raised by the private sector and to finalise this Standardisation. This issue is the first official issue of this Standardisation.

The National Treasury recognises that this Standardisation is a "living" document that will need to respond to future developments affecting the PPP market in South Africa. Accordingly, users hereof are invited and encouraged to submit any comments they may have from time to time to the National Treasury. These comments must be submitted at the address(es) indicated on the National Treasury's website (www.treasury.gov.za).

The National Treasury would like to acknowledge the role that the document "Standardisation of PFI Contracts (SoPC)", published by Her Majesty's Treasury of the United Kingdom, has played in inspiring this Standardisation. In particular, the National Treasury is most appreciative of the contribution made by Partnerships UK plc, whose input was informative, and whose participation benefited this Standardisation substantially. Gratitude is extended to the Department for

International Development, whose assistance has facilitated the involvement of international consultants. Other similar international guidances were also consulted, and influenced this Standardisation.

The National Treasury wishes to express its sincere thanks to all those organisations and individuals from both the public sector and the private sector who participated in the process. In particular, thanks are extended to Drake & Skull FM, Ledwaba Mazwai, Masons, Nedbank Corporate, Outsourcing Advisory Services, Standard Corporate & Merchant Bank, Turner & Townsend and Utho Capital for making members of their staff available to participate in the Review Group. Special mention is made of the contributions made by the International Project Finance Association, the South African Federation of Civil Engineering Contractors, the South African Facilities Management Association and Alexander Forbes Risk Services.

GLOSSARY

The following acronyms are used in this Standardisation:

BEE	Black Economic Empowerment
ECA	Environment Conservation Act, 1973
EIA	Environmental Impact Assessment
IDP	Integrated Development Plan
IRR	Internal Rate of Return
JIBAR	Johannesburg Inter-bank Agreed Rate
NEMA	National Environmental Management Act, 1998
NPV	Net Present Value
PFMA	Public Finance Management Act, 1999
PPP	Public Private Partnership
PPPU	Public Private Partnership Unit of the National Treasury
RFQ	Request for Pre-qualifications
RFP	Request for Proposals
SAHRA	South African Heritage Resources Agency
SANRAL	South African National Roads Agency Limited
SMME	Small, Medium or Micro Enterprise
SPV	Special Purpose Vehicle
TA:I	Treasury Approval: I
TA:IIA	Treasury Approval: IIA
TA:IIB	Treasury Approval: IIB
TA:III	Treasury Approval: III
VAT	Value-Added Tax

PART A: PRELIMINARY

1 DEFINITIONS

The following definitions are used in this Standardisation, unless otherwise stated, and should, where appropriate, be incorporated in the definitions clause of the PPP Agreement.

Standard Definitions

Definitions

In this PPP Agreement, unless the context otherwise requires, the following capitalised terms shall have the meanings assigned to them below and cognate expressions shall have corresponding meanings:

"Affiliate"	*any person that directly or indirectly through any one or more intermediaries controls, is controlled by or is under common control with any person, where "control" means the ability to direct or cause the direction of the business affairs and management policies or practices of a person;*
"Agreed Form"	*in relation to any document not executed simultaneously with this PPP Agreement, the terms and conditions of that document have been agreed by the Parties and initialled by each of them for identification purposes on or before the Signature Date;*[22]
"Availability Certificate"	*the certificate to be issued by the Private Party certifying that the Services are available;*
"Availability Deductions"	*has the meaning set forth in Schedule [x];*[23]
"Business Day"	*any day except a Saturday, Sunday or public holiday in the Republic of South Africa;*
"Capital Expenditure"	*any expenditure treated as capital expenditure under GAAP;*
"Compensation Events"	*has the meaning set forth in Clause [x];*[24]

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22 It is preferable to have all the Project Documents signed simultaneously. To the extent that this is not possible, the concept of "Agreed Form" should be used.

23 A detailed Schedule regarding the payment mechanism, including all deductions to be made from the Unitary Payment, must be attached to the PPP Agreement. Unlike Performance Deductions, which are deductions for poor performance, Availability Deductions relate to unavailability of the more critical aspects of Services.

24 See Part J: (*Relief Events, Compensation Events and Force Majeure*).

"Completion Certificate"	*the certificate to be issued by the Independent Certifier, declaring that the Works have been completed, in accordance with Clause [x];*[25]
"Consents"	*all consents, permits, clearances, authorisations, approvals, rulings, exemptions, registrations, filings, decisions, licences, required to be issued by or made with any Responsible Authority in connection with the performance of any of the Project Deliverables;*[26]
"Construction Subcontract"	*the contract between the Private Party and the Construction Subcontractor in respect of the Works;*
"Construction Subcontractor"	*[x], being the person appointed by the Private Party to undertake the Works;*[27]
"Corrupt Act"	*has the meaning set forth in Clause [x];*[28]
["CPIX"	*the consumer price index excluding interest on mortgage bonds, for metropolitan and other urban areas (Base 2000=100) published from time to time by Statistics SA in Statistical Release PO141.1; provided that if:* *(a) such index ceases to be published; or* *(b) the Institution and the Private Party agree (or, failing agreement, if it is determined by the [Independent Expert] pursuant to Clause [x] (Fast-track Dispute Resolution)) that due to a change in circumstances such index is no longer representative, then from the date when the index was last published, the Parties shall use such other index as agreed between them or, failing agreement, as determined by the [Independent Expert] as being a fair and reasonable replacement index;]*[29]

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25 See Part E: (*Duration and Service Commencement*).

26 This excludes any third party consents from non-governmental authorities.

27 Insert the name of the applicable person. For projects that do not involve construction works (for example, some IT projects) other appropriate language should be used.

28 See Part N:60.5 (*Termination: Termination for Corrupt Acts*).

29 See Part H:37.2.4 (*Payment and Financial Matters*). The PPP Agreement must identify the Independent Expert who will determine the replacement index should the Parties fail to reach agreement. Refer to Part S:86.2 (*Miscellaneous: Fast-track Dispute Resolution*) for guidance on the appointment and role of Independent Experts and the manner in which the fast-track dispute resolution procedure should be conducted.

"Debt"	*at any date, all amounts due and payable by the Private Party that are outstanding under the Financing Agreements at that date, but excluding all default interest, breakage premiums as well as all fees, costs and expenses whatsoever in connection with any hedging arrangements entered into by the Private Party;*[30]
"Default Interest Rate"	*[x];*[31]
"Direct Agreement"	*the agreement so titled between the Lenders (or their nominated agent), the Private Party and the Institution concluded simultaneously herewith or in the Agreed Form;*[32]
"Equity"	*the entire issued share capital of the Private Party;*[33]
"Expiry Date"	*the [x]th anniversary of the [Signature Date];*[34]
"Facilities"	*[the buildings and other facilities together with all supporting infrastructure, plant and equipment] as required to enable the Private Party to exercise its rights and perform its obligations included in the Project Deliverables;*[35]
"Final Bond"	*has the meaning set forth in Clause [x];*[36]
"Financial Model"	*the financial base case for the Project as reflected in the computer model attached to this PPP Agreement on disk as Schedule [x], which model incorporates the forecast cash flow statements of the Private Party including all expenditure, revenues, taxation and financing of the Project Deliverables together with the income statements and balance sheets for the Private Party over the Project Term, and*

30 This definition also excludes Shareholder Loans.

31 This is the interest rate at which all overdue Unitary Payments and other overdue amounts under the PPP Agreement will attract interest. This will usually be the base rate for example JIBAR, plus a "punitive" margin as specified. This should be established on a project-by-project basis.

32 See Part O:73 (*Step-in: By the Lenders*).

33 This definition excludes Shareholder Loans.

34 The preferred approach in this Standardisation entails that the PPP Agreement comes into full force and effect at the Signature Date and that its effectiveness will not be subject to the fulfilment of suspensive conditions. Accordingly, the term "effective date", to the extent that it signifies a date later than the Signature Date upon which the PPP Agreement comes into effect (pending fulfilment of suspensive conditions), is not used in this Standardisation. If having regard to the circumstances described in Part A:3 (*Preliminary: Conditions*) it is appropriate for the coming into effect of a PPP Agreement to be suspended pending the fulfilment of any suspensive conditions, then the concept of an "Effective Date", being the date when the last of the suspensive conditions has been fulfilled (or waived), may be included in the PPP Agreement and the "Project Term" will run from that date.

35 This definition will be project-specific. The definition used here is appropriate for a hospital, head office or school accommodation project.

36 See Part F:32.6 (*Services: Security for Final Maintenance Obligations*).

	details of all assumptions, calculations and methodology used in the compilation thereof, as amended from time to time in accordance with the Financing Agreements;[37]
"Financing Agreements"	*the agreements relating to the Debt*[38] *listed in Schedule [x] in their form as at the Signature Date and excluding all amendments thereto not approved in advance by the Institution in accordance with Clause [x];*[39]
"Force Majeure"	*has the meaning set forth in Clause [x];*[40]
"GAAP"	*generally accepted accounting practice in the Republic of South Africa as approved from time to time by the South African Accounting Practices Board;*
"Good Industry Practice"	*applying, in relation to the manner in which the Works are performed and the Services rendered, the standards, practices, methods and procedures conforming to applicable law, and exercising that degree of skill, care, diligence, prudence and foresight that would reasonably and ordinarily be expected from a skilled and experienced person engaged in a similar type of undertaking under similar circumstances;*[41]

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37 See Part B:4.2 (*Project Documents and Project Deliverables: Amendments and Waivers*).

38 In the case of the Debt, the Financing Agreements usually include a loan facility, credit or common terms agreement and security documents (such as cessions in security over the bank accounts of the Private Party).

Given the Institution's potential liability on termination of the PPP Agreement for the Debt, the Equity and the Shareholder Loans, it is essential that the Institution conducts a careful due diligence of the Financing Agreements and the Shareholders Agreement to establish the amounts comprising the Debt, the Equity and the Shareholder Loans and, in particular, to ensure that the Financing Agreements and Shareholders Agreement do not include amounts that are unusual or otherwise not market standard. In this regard, see Part B:4.3 (*Project Documents and Project Deliverables: Due Diligence*). All amounts over and above outstanding capital and interest, such as default interest and breakage (or unwinding) fees, penalties, premiums and costs, will have to be considered. Consideration will also have to be given to the inclusion of the cost of any interest rate hedging arrangements, where the interest rate on any financing made available for the Project is a variable rate (such as JIBAR).

Further, it is essential that if the PPP Agreement provides for the Institution to pay any part of the Debt following termination of the PPP Agreement, then any amount included in the Debt that an Institution is not willing to pay must be excluded, whether in the definition of "Debt" or elsewhere in the PPP Agreement. See the definition of "Debt" and footnote 30.

39 See Part B:4.2 (*Project Documents and Project Deliverables: Amendments and Waivers*).

40 See Part J:48 (*Relief Events, Compensation Events and Force Majeure: Force Majeure*).

41 Good Industry Practice is a comparative measure that relates to the manner in which the Services are provided and not to the nature or scope of the Services. Depending on the project, it may be appropriate to limit Good Industry Practice to the standards used in the Republic of South Africa. In other projects, it may be advisable for Good Industry Practice to be determined with reference to international standards. The Institution should generally ensure that the geographical scope of these standards is the same for other projects in the same sector. The Institution should seek specific advice on this issue from its technical advisors before the commencement of the procurement phase of the Project. To the extent that a comparison can be made against objective standards, this should be done.

"Independent Certifier"	*the independent certifier appointed by the Parties pursuant to Clause [x]*[42] *and who is responsible for issuing the Completion Certificate declaring that the Works have been completed;*[43]
"Independent Expert"	*[x];*[44]
"Institution"	*[x];*[45]
"Institution Assets"	*any assets and rights made available by the Institution to the Private Party for use in the Project Deliverables, including the Project Site;*[46]
"Institution Default"	*has the meaning set forth in Clause [x];*[47]
"Intellectual Property"	*all intellectual property whatsoever used from time to time in connection with the Works and/or the Services whether capable of registration, registered or not;*[48]
"Lenders"	*any person providing financing to the Private Party under the Financing Agreements;*
"Licensed Intellectual Property"	*all Intellectual Property to be used under licence from any third party;*[49]
"Long Stop Date"	*[[x], being the date by which the Services must have commenced, failing which the Institution shall be entitled to terminate this*

42 See Part E: (*Duration and Service Commencement*).

43 The role of the Independent Certifier is separate from that of the Institution's own technical advisors (who assist in the technical review of proposals during the procurement phase of a project) and also from that of the Independent Experts (who, in specified instances, are responsible for adjudicating certain disputes between the Parties – these are usually disputes relating to technical or financial issues requiring fast-track resolution, which is not always possible using the ordinary dispute resolution procedures). See Part S:86.2 (*Miscellaneous: Fast-track Dispute Resolution*). On the other hand, the Independent Certifier is responsible for certifying that the construction or development works have been completed in accordance with the PPP Agreement. See Part E:19 (*Duration and Service Commencement: Independent Certifier*).

44 Depending on the particular project there may be a need for several Independent Experts (with expertise in different areas, such as IT, finance, civil engineering and socio-economic matters) to determine disputes arising under the PPP Agreement on a fast-track basis. The PPP Agreement should clearly stipulate for the independence of all such experts and specify which disputes are to be determined by which Independent Expert. See Part S:86.2 (*Miscellaneous: Fast-track Dispute Resolution*).

The definition must distinguish between the different Independent Experts required for a project.

45 Insert the name of the Institution procuring the PPP.

46 This definition anticipates that these assets may not necessarily be "owned" by the Institution itself. In this regard, see Part D: (*Project Site*).

47 See Part N: (*Termination*).

48 Having regard to Treasury Regulation 16.7.3, the PPP Agreement should identify all Intellectual Property (if any) belonging to the state to be made available by the Institution to the Private Party in connection with the Project and should contain adequate protections against the forfeiture of the state's interests in and to such Intellectual Property. See Part R: (*Intellectual Property*).

49 As part of its due diligence, the Institution must request the Private Party to make full disclosure of all Intellectual Property to be used by the Private Party under licence from third parties. These licences must be reviewed in order to ensure that they are transferable to the Institution on termination of the PPP Agreement or directly grant the Institution adequate usage rights to continue using the Intellectual Property after the PPP Agreement terminates. If the Private Party requires the use of Intellectual Property held by the Institution under licence from a third party, the Institution should first ensure that the licence terms permit the Institution to grant such use rights. See Part R: (*Intellectual Property*).

	PPP Agreement in accordance with the provisions in Clause [x]];[50]
"Net Cash Flow"	*at any date:* *(a) all monetary sums of an income nature received by the Private Party at that date; plus* *(b) all amounts drawn down by the Private Party under the Financing Agreements at that date; less* *(c) all expenditure of the Private Party at that date in relation to the Project Deliverables (excluding interest);*
"Operating Expenditure"	*any expenditure treated as operating expenditure under GAAP;*
"Operations Subcontract"	*the contract between the Private Party and the Operations Subcontractor in respect of the Services;*
"Operations Subcontractor"	*[x], being the person appointed by the Private Party to perform the Services;*[51]
"Parties"	*the Private Party and the Institution;*
"Penalty Deductions"	*the Availability Deductions and the Performance Deductions;*
"Performance Deductions"	*has the meaning set forth in Schedule [x];*[52]
"PPP Agreement"	*this public private partnership agreement between the Parties, being a public private partnership agreement as contemplated in Treasury Regulation 16 of the Treasury Regulations for Departments, Trading Entities, Constitutional Institutions and Public Entities issued under the Public Finance Management Act, 1999;*
"Private Party"	*[x];*[53]
"Private Party Default"	*has the meaning set forth in Clause [x];*[54]
"Project"	*[x];*[55]

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50 See Part N:60 (*Termination: Causes of Termination*). This is a fixed date by when the provision of the Services must commence failing which the Institution will terminate the PPP Agreement. Whether the use of a Long Stop Date is appropriate depends on the sector and on the specific circumstances of a project. In this regard, see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*). The Long Stop Date should be significantly later than the Scheduled Service Commencement Date in order to avoid hair-trigger termination.

51 Insert the name of the applicable person.

52 The schedule regarding the payment mechanism must include details of the deductions from the Unitary Payment that may be made for poor performance as well as details of the specific areas of performance. Unlike Availability Deductions, Performance Deductions do not relate to critical aspects of the Services but rather to the less critical areas and are more performance-related. See also Part H: (*Payment and Financial Matters*).

53 Insert the name of the Private Party to the PPP Agreement.

54 See Part N: (*Termination*).

55 This term should be defined on a project-specific basis.

"Project Assets"	*all assets as required [to design, construct, develop, install, commission, operate and/or maintain the Project including the Facilities, any books and records, any spare parts and tools], as well as the Intellectual Property and the Institution Assets, but excluding all cash;*[56]
"Project Deliverables"	*the [carrying out of the Works, the installation, commissioning, operation and maintenance of the Project Assets including the repair, renewal or replacement thereof, the management and provision of the Services] and the exercise and performance of all other rights and obligations of the Private Party under this PPP Agreement from time to time;*[57]
"Project Documents"	*the Financing Agreements, the Shareholders Agreement, the Subcontracts and all other contracts described in Schedule [x]*[58] *relating to the performance of the Project Deliverables, each executed by the parties thereto simultaneously with this PPP Agreement or otherwise in the Agreed Form;*
"Project Insurances"	*has the meaning set forth in Clause [x] (Insurance);*[59]
"Project Officer"	*the official designated by the [accounting officer/accounting authority] of the Institution on notice to the Private Party as the project officer for the Project. The Institution may replace the project officer from time to time on prior written notice to the Private Party;*[60]
"Project Site"	*the [land made available by the Institution to the Private Party] for the conduct of the Project Deliverables as further described in Schedule [x];*[61]

56 This definition will be project-specific and thus appropriate amendments may be made. In so far as Institution Assets are included in this definition, bidders should include as part of their due diligence in the bid phase of a Project a detailed analysis of the condition, life expectancy and maintenance and replacement cycle of such equipment.

57 This definition will be project-specific and thus appropriate amendments may be made.

58 These will include the contracts appointing any Independent Experts and any other subcontractors appointed directly by the Private Party (so-called "first-tier" subcontractors) but not the subcontracts between these first-tier subcontractors and their subcontractors (so-called "second-tier" subcontractors).

The Private Party should be obliged under the PPP Agreement to identify all Project Documents which are necessary for it to be able to perform the Project Deliverables. The list should (in this sense) be a "closed list".

59 See Part I:40 (*Insurance: Insurance Requirements*).

60 The appointment of project officers for projects is prescribed by Treasury Regulation 16.3.1. Institutions should refer to Module 3: PPP Inception and Module 6: Managing the PPP Agreement for guidance on the role of project officers.

61 This definition applies to infrastructure projects for the construction of Facilities where the state usually owns the land on which the Facilities are to be constructed. It does not presume, however, that the Institution that is procuring the Project Deliverables will itself own the land. For instance, the land could be owned by another organ of state and leased or otherwise made available

"Project Site Agreement"	*the agreement between the Parties in connection with the Project Site attached hereto as Schedule [x];*
"Project Term"	*the period from the [Signature Date]*[62] *to the Expiry Date or the Termination Date, whichever occurs first;*
"Refinancing"	*has the meaning set forth in Clause [x];*[63]
"Relief Event"	*has the meaning assigned thereto in Clause [x];*[64]
"Responsible Authority"	*any ministry, any minister, any organ of state, any official in the public administration or any other governmental or regulatory department, commission, institution, entity, service utility, board, agency, instrumentality or authority (in each case, whether national, provincial or municipal) or any court, each having jurisdiction over the matter in question, but excluding for all purposes the Institution;*
"Scheduled Service Commencement Date"	*the date stipulated in the Works programme as the day after the date on which the Availability Certificate is scheduled to be issued and the Services are due to commence;*
"Service Commencement"	*the actual commencement of the Services, subsequent to the issue of the Availability Certificate in accordance with Clause [x];*[65]
"Service Commencement Date"	*the date of Service Commencement as stated in the Availability Certificate issued by the Private Party in accordance with Clause [x];*[66]

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to the Institution. If an Institution intends to use land falling under the control of another institution, then the Institution should resolve all inter-governmental matters regarding the control of the land in question before its application for TA:I. In this regard, see Part D: (*Project Site*).

Since the definition of "Project Site" is project-specific, appropriate amendments will have to be made.

62 See footnote 34. If having regard to the circumstances described in Part A:3 (*Preliminary: Conditions*) it is appropriate for the coming into effect of the PPP Agreement to be suspended pending the fulfilment of any conditions, then the Project Term will run from the effective date of the PPP Agreement (being the date when the last of the suspensive conditions has been fulfilled (or waived)), and not the Signature Date.

63 See Part Q: (*Refinancing*).

64 See Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*).

65 See Part E: (*Duration and Service Commencement*).

66 See Part E: (*Duration and Service Commencement*). This date is critical for the purposes of establishing the commencement of payment of the Unitary Payments, the duration of the Service Period and the implications of early or late Service Commencement.

This Standardisation assumes that there is a single Service Commencement Date, but this may not always be appropriate. In some projects, in particular, toll road projects, the commencement of the Services may occur in phases as different sections of the road are commissioned at different times.

Ideally, the Institution should not use the Facilities prior to the issuing of the Availability Certificate. To the extent that this is unavoidable, the PPP Agreement should clearly stipulate that such use should not be deemed to constitute "acceptance" by the Institution nor should it relieve the Private Party from its obligations to satisfactorily complete the Works.

"Service Period"	*the period from the Service Commencement Date to the Expiry Date, unless this PPP Agreement is terminated earlier in accordance with its terms;*
"Services"	*the operational services to be provided by or on behalf of the Private Party for the Institution as set forth in Schedule [x], as may be subsequently amended in accordance with this PPP Agreement;*[67]
"Shareholder Loans"	*at any date, in relation to any financing (other than the Equity and the financing under a Financing Agreement) made available for the Project by the Shareholders, all principal unpaid at that date;*
"Shareholders"	*the holders of the Equity;*
"Shareholders Agreement"	*the agreement(s) between the Shareholders and/or the Private Party in respect of the Equity and/or Shareholder Loans;*[68]
"Signature Date"	*the date of signature of this PPP Agreement by the last signing Party;*
"Subcontracts"	*the Construction Subcontract and the Operations Subcontract;*[69]
"Subcontractor Costs"	*all damages, losses, liabilities, costs, and expenses (including legal costs and expenses) ("Losses") that have been or will be reasonably and properly incurred by the Private Party as a direct result of the termination of this PPP Agreement, but only to the extent that:* *(a) the Losses are incurred in connection with the provision of Services or the completion of the Works by the Subcontractors, including, without limitation:* *(i) the cost of any materials or goods ordered or Subcontracts placed that cannot be cancelled without such Losses being incurred;*

67 This refers to the operating rights and obligations of the Private Party to be delivered during the Service Period. The specific nature of the Services required is project-specific. The definition must be as inclusive as possible and cover all elements of the scope and nature of the Services to be provided.

68 This definition is wide enough to include the agreements in respect of the Shareholder Loans and subscriptions for Equity, and also the agreement (if separate) governing other matters affecting the Shareholders and their relationships among each other and with the Private Party.

69 This definition is limited to the first-tier subcontractors.

(ii) *Subcontractor losses of profits for a period not exceeding [__]*[70]

(iii) *any expenditure incurred in anticipation of the provision of the Services or the completion of Works;*

(iv) *the cost of demobilisation including the cost of any relocation of equipment used in connection with the Project; and*

(v) *retrenchment payments; and*

(b) *the Losses are incurred under arrangements and/or agreements that are consistent with terms that have been entered into in the ordinary course of business and on reasonable commercial terms; and*

(c) *each of the Private Party and the relevant Subcontractor has used reasonable endeavours to mitigate its Losses;*

"Subcontractors"	*the counter-parties of the Private Party to the Subcontracts including the Construction Subcontractor and the Operations Subcontractor;*[71]
"Termination Date"	*any date of early termination of this PPP Agreement in accordance with its terms;*
"Unforeseeable Conduct"	*has the meaning set forth in Clause [x];*[72]
"Unitary Payments"	*the charges payable to the Private Party in connection with the performance of its obligations included in the Project Deliverables as calculated in accordance with Clause [x];*[73]

70 Subcontractor Costs should be carefully calculated so as not to extend beyond first-tier subcontractors, and to include future subcontractor (first-tier only) losses of profits up to a limit to be established with reference to a specified period. In determining the period for which the Institution should compensate the Private Party for Subcontractor losses of profits, the Institution must take into account (i) the particular sector or industry; (ii) the likely waiting time before the Subcontractor will procure another project; and (iii) the expired duration of the Project Term so that the greater the unexpired portion of the Project Term, the higher the amount that the Institution should pay. Currently, losses of profits should in any event be compensated for a period of between one to five years, taking into account the above factors. As the PPP market in South Africa develops, this time period should shorten.

71 This should only include first-tier Subcontractors and not any subcontractors of the first-tier Subcontractors.

72 See Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*).

73 See Part H: (*Payment and Financial Matters*). The consideration payable to the Private Party for the Project Deliverables may be in the form of unitary payments payable by the Institution, or user charges collected by the Private Party that derive from the provision of the Services to users other than the Institution (for example, tolls payable by toll road users). See Part H: (*Payment and Financial Matters*). Appropriate amendments will have to be made in the PPP Agreement where the latter is the case.

"Variations"	*any variations to the Project Deliverables in accordance with Clause [x];*[74]
"VAT"	*any value-added tax or any similar tax which is imposed in place of or in addition to such tax; and*
"Works"	*the [design, construction, fitting, installation and commissioning] works to be undertaken by the Private Party as detailed in Schedule [x].*[75]

2 INTERPRETATION

The PPP Agreement should include provisions setting forth the agreed principles that will govern the interpretation of the language, definitions and other terms used in the PPP Agreement.

Standard Clause

Interpretation

This PPP Agreement shall be interpreted according to the following provisions, unless the context requires otherwise:

(a) References to the provisions of any law shall include such provisions as amended, re-enacted or consolidated from time to time in so far as such amendment, re-enactment or consolidation applies or is capable of applying to any transaction entered into under this PPP Agreement.

(b) References to "indexed to [CPIX]" in relation to any amount of money shall mean that such amount has been expressed in [month and year in which the Signature Date occurs] prices and shall be escalated annually as at the Signature Date and each anniversary thereof with reference to the then most recent publication of the [CPIX], subject to adjustments for any rebasing or recalculation thereof in accordance with the formula contained in Schedule [x].

(c) References to "Parties" shall include the Parties' respective successors-in-title and, if permitted in this PPP Agreement, their respective cessionaries and assignees.

(d) References to a "person" shall include an individual, firm, company, corporation, juristic person, Responsible Authority, and any trust, organisation, association or partnership, whether or not having separate legal personality.

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[74] See Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*).

[75] A detailed Schedule setting out the scope and standards of the construction (or development) works must be prepared and attached to the PPP Agreement.

(e) *References to any "Responsible Authority" or any public or professional organisation shall include a reference to any of its successors or any organisation or entity, which takes over its functions or responsibilities.*

(f) *References to "Clauses", "sub-Clauses" and "Schedules" are references to the clauses, sub-clauses and schedules of this PPP Agreement.*

(g) *The headings of Clauses, sub-Clauses and Schedules are included for convenience only and shall not affect the interpretation of this PPP Agreement.*

(h) *The Schedules to this PPP Agreement are an integral part of this PPP Agreement and references to this PPP Agreement shall include the Schedules.*[76]

(i) *The Parties acknowledge that each of them has had the opportunity to take legal advice concerning this PPP Agreement, and agree that no provision or word used in this PPP Agreement shall be interpreted to the disadvantage of either Party because that Party was responsible for or participated in the preparation or drafting of this PPP Agreement or any part of it.*

(j) *Words importing the singular number shall include the plural and vice versa, and words importing either gender or the neuter shall include both genders and the neuter.*

(k) *References to "this PPP Agreement" shall include this PPP Agreement as amended, varied, novated or substituted in writing from time to time.*

(l) *References to any other contract or document shall include (subject to all approvals required to be given pursuant to this PPP Agreement for any amendment or variation to or novation or substitution of such contract or document) a reference to that contract or document as amended, varied, novated or substituted from time to time.*

(m) *General words preceded or followed by words such as "other" or "including" or "particularly" shall not be given a restrictive meaning because they are preceded or followed by particular examples intended to fall within the meaning of the general words.*

3 CONDITIONS

3.1 This Standardisation assumes that the Signature Date and the date when the PPP Agreement comes into full force and effect will be the same. In other words, it assumes that the coming into effect of the PPP Agreement will not be suspended pending the fulfilment of conditions (so-called "suspensive conditions" or "conditions precedent"). It further assumes that where the Signature Date and the effective date correspond, the continued effectiveness

[76] See Part B:5 (*Project Documents and Project Deliverables: Schedules*).

of the PPP Agreement will not be set aside following the occurrence or non-occurrence of future conditions (so-called "resolutive conditions" or "conditions subsequent").[77]

3.2 This approach minimises the risk that the PPP Agreement will fail for non-fulfilment of conditions that could be managed otherwise by the Parties, for instance, by other mechanisms in the PPP Agreement such as an extension of time and/or compensation. However, depending on the particular circumstances of each PPP and the nature of the condition, this approach might not always be appropriate. Thus if this approach is not legally possible or it creates any material practical difficulties and better value for money can be achieved for the Institution by it agreeing that certain conditions will suspend the enforceability (or terminate the continued enforceability) of the PPP Agreement, then the Institution may depart from this approach and agree to the inclusion of conditions in the PPP Agreement.[78]

3.3 Typically, conditions entail the obtaining of third party Consents required for the performance of the Project Deliverables. At the commencement of the PPP negotiations, the Institution and the Private Party should identify:

3.3.1 all Consents required for the Project;

3.3.2 the Party responsible for obtaining each Consent;

3.3.3 the earliest practical date by when each Consent can be obtained;

3.3.4 whether the obtaining of any Consent that can only be obtained after the anticipated Signature Date should be treated as a suspensive condition or whether the failure to obtain such Consent should be treated as a resolutive condition.

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[77] The Lenders will generally require that their obligations to advance, from time to time, any funding under the Financing Agreements be subject to the fulfilment of several suspensive conditions including the obtaining of all Consents required for the commencement of the construction Works, for example, environmental Consents such as a record of decision approving any environmental impact assessment ("**EIA**") as may be required under applicable environmental law. This should not, however, affect the Institution's determination of what (if any) suspensive conditions may be appropriate to suspend the coming into effect (as between the Institution and the Private Party) of the PPP Agreement. Since the Debt funding will not be available for drawing by the Private Party until the conditions to drawing under the Financing Agreements have been fulfilled (or waived), the availability of the Equity funding and Shareholder Loans will be critical in the early mobilisation phase of a Project.

[78] See Section 3.8, but compare Sections 3.4 to 3.7. All conditions must be clearly identified and explained by the Institution in its application for TA:IIA and, in the case of conditions negotiated with the successful bidder, in its application for TA:III.

While this process of identifying all required Consents should as far as possible be an interactive one, the PPP Agreement should reflect that the Private Party ultimately bears the responsibility (as between the Parties) for identifying all Consents that are required by it (or the Subcontractors) to perform the Project Deliverables.

3.4 Any Consents that are required to give either Party the necessary authority and power to sign the PPP Agreement should be obtained by the Party concerned before the signature of the PPP Agreement and should *not* be treated as suspensive or resolutive conditions. This also applies to any Treasury Approvals required pursuant to Treasury Regulation 16 from the relevant Treasury for the approval of a PPP.[79] It also applies to all corporate approvals (that is, all resolutions of the board of directors and the shareholders of the Private Party) required for the incorporation of the Private Party and to authorise the execution of the PPP Agreement by its representatives and its performances thereunder, as well as to all related regulatory approvals and filings required under the Companies Act, 1973 in connection with the incorporation of the Private Party. It is *not* appropriate for the PPP Agreement's enforceability to be suspended pending the incorporation of the Private Party and the taking of all corporate action necessary to authorise the execution and performance of the PPP Agreement.[80]

3.5 In PPPs for the performance of an institutional function, any Consents relating to the appropriate zoning or re-zoning of, and any appropriate land-use Consents required to permit the conduct of the Project Deliverables at, the Project Site should be the responsibility of the Institution, which must obtain these Consents well before the signing of the PPP Agreement (at the feasibility study phase). The same principle applies to any macro-level environmental

[79] It should be borne in mind that the Treasury Approval process provided for in the Treasury Regulations will not obviate other necessary approvals. As indicated elsewhere in this Standardisation, at the feasibility study stage of a PPP, the accounting officer or accounting authority, as the case may be, of the Institution must identify the extent to which the institutional function or use of state property can legally be performed by a Private Party in terms of a PPP Agreement. This should entail, among other things, the identification of all necessary Consents – for example, any approval required pursuant to section 54(2)(b) of the PFMA, which obliges the accounting authority of a public entity listed in Schedule 3 to the PFMA to obtain, before that public entity concludes any transaction involving its participation in a "significant partnership", the approval of the executive authority (Minister or MEC, as the case may be) that is accountable for that public entity or in whose portfolio it falls.

[80] If any of the Shareholders of the Private Party are non-residents, any exchange control Consent required by them should be obtained by the Signature Date. The Institution should not agree that the obtaining of these Consents be a suspensive condition of the PPP Agreement.

assessment or report required pursuant to NEMA in relation to any such PPP.[81] The obtaining of these Consents should *not* be treated as a condition for the enforceability (or continued enforceability) of the PPP Agreement.

3.6 The obtaining of any Consents relating to the design, construction, engineering, technical and installation specifications put forward by the Private Party (such as, any building Consent and any record of decision regarding any EIA required for the Works) should be the responsibility of the Private Party and should not be treated as suspensive conditions. This is because the Private Party bears the design and construction risks in the Project and, therefore, it should also assume the responsibility for identifying and obtaining all design and construction-related Consents, otherwise these risks will be transferred back to the Institution.[82] Accordingly, the Private Party should be required to allocate adequate time in its Works programme for the obtaining of all such Consents. Delays in the obtaining of such Consents should not delay the coming into effect of the PPP Agreement, but may instead be dealt with through alternative mechanisms (such as Relief Events) to the extent that such delays are not attributable to any fault on the part of the Private Party or its Subcontractors.[83]

3.7 In the case of Consents required pursuant to the merger provisions of the Competition Act, 1998, for instance, if the PPP involves the transfer of control over any existing facilities and/or assets from the Institution (or any other governmental authority) to the Private Party, these can and should be obtained before the Signature Date and should not be treated as conditions. This is because that Act requires that all merger consents required thereunder be obtained from the competition authorities *before the implementation* of the agreement effecting such transfer. Accordingly, the Institution and the Private Party should approach the competition authorities as soon as the PPP Agreement has been finalised, but before its execution. In effect, the

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81 See Part D:13 (*Project Site: Planning Consents and Risks*) and Part D:14 (*Project Site: Environmental Consents and Risks*).

82 The Institution should, however, provide any reasonable assistance to the Private Party in this regard.

83 See Part D:13 (*Project Site: Planning Consents and Risks*), Part D:14 (*Project Site: Environmental Consents and Risks*) and Part J: (*Relief Events, Compensation Events and Force Majeure*).

timing of the application for any such merger Consent should coincide with the application for TA:III and the Institution should inform the relevant Treasury that an application for merger Consent is pending before the competition authorities.

3.8 Depending on the nature of the project, other Consents or actions may be required from, among others, sector-specific regulators to permit the Private Party (or the Subcontractors) to undertake aspects of the Project Deliverables. The timing of any sector-specific Consent or action will usually depend on the requirements of the legislation applicable to the sector concerned.[84] In some instances, such Consents may only be granted after a Private Party has already undertaken certain activities contemplated in a PPP Agreement. If any sector-specific legislation only allows for a Consent to be granted or action taken by the relevant regulator after certain activities contemplated in the PPP Agreement have been completed, then it may be appropriate to deal with these Consents or actions as conditions.

3.9 Any conditions agreed to by the Institution must be carefully drafted so as to ensure that the Institution does not inadvertently take back risks that have been allocated to the Private Party. In addition, the Institution should consider requiring the Private Party or its funders to furnish security to the Institution to cover the Institution's wasted costs if such conditions are not fulfilled because of the failure on the part of the Private Party to use all reasonable efforts to ensure that such conditions are fulfilled.[85]

[84] For example, the South African National Roads Agency Limited and National Roads Act, 1998 requires that agreements concluded by SANRAL (a public entity listed in Schedule 3 to the PFMA) with private parties for the operation, management, control and maintenance of a national toll road, and for the financing, planning, design, construction, maintenance or rehabilitation of a national road be approved by the Minister of Transport. This Act also requires that the tariff for any tolls to be levied in a toll road project by a private service provider shall be determined by the Minister of Transport by notice in the Government Gazette.

[85] See Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) for a discussion on various kinds of security.

PART B: PROJECT DOCUMENTS AND PROJECT DELIVERABLES

4 PROJECT DOCUMENTS

4.1 Introduction

4.1.1 The Private Party should be obliged as a term of the PPP Agreement to identify all Project Documents (in a Schedule to the PPP Agreement) that are necessary for it to be able to perform the Project Deliverables.[86]

4.1.2 The Institution must review and be satisfied with the terms and conditions of the final execution form of each Project Document, and the Parties should endeavour to ensure that each Project Document is executed simultaneously with the PPP Agreement. If this is not practical, then the Institution should ensure that any Project Document not executed at the signing of the PPP Agreement is in final Agreed Form by the Signature Date. This is typically done by the Parties initialling each page of the final Agreed Form (for identification purposes) and agreeing that the Institution will have the right to agree to all amendments to the final Agreed Form.

4.2 Amendments and Waivers

4.2.1 Generally, any amendments to, or waivers of any rights under, any Project Document to which the Institution is not a party must be subject to prior notice to, and the written agreement of, the Institution.[87] The only exception to this is for Exempt Refinancings, where notification to the Institution is required but the agreement of the Institution is not.

4.2.2 The Institution should not agree to any amendment of, or waiver of any rights under, any Project Document if such amendment or waiver may

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[86] The Project Documents typically include the Subcontracts, the agreements for the appointment of the Independent Certifier and any Independent Experts, the Financing Agreements, the Shareholders Agreement and the Project Site Agreement.

[87] If the Institution is a direct party to a Project Document or is expressly entitled to accept any rights arising under it for its own direct benefit (by way of a so-called "*stipulatio alteri*" or "stipulation in favour of another"), which may be the case in relation to agreement(s) for the appointment of any Independent Expert(s), then there will be no need to provide for a specific right in the PPP Agreement for the Institution to limit the ability of the Private Party to agree on changes to any such Project Document since the Private Party would in any event not be able to do so without involving the Institution.

impact negatively on value for money, affordability or the risk profile of the Project. If such amendment or waiver also entails an amendment to the PPP Agreement itself that may be material, then the Institution may not agree to such amendment without the prior written approval of the relevant Treasury. Such approval will only be given if the PPP Agreement, as amended, will continue to provide value for money, be affordable for the Institution and transfer substantial risk to the Private Party.[88]

Standard Clause

<u>*Project Documents*</u>

(a) The Private Party must comply with the provisions of the Project Documents and, save as otherwise provided in relation to Exempt Refinancings or Permitted Borrowings, may only:

(i) terminate, or make any amendment to (or otherwise agree to do so) any Project Document; or

(ii) in any respect, depart from its obligations or waive any rights under any Project Document,

with the prior written agreement of the Institution.[89]

(b) The Private Party shall procure that any Project Document not executed simultaneously with this PPP Agreement is executed in the Agreed Form annexed to this PPP Agreement.

(c) Without limiting the restrictions on amendments to the Project Documents in Clause (a) above, the Private Party shall furnish the Institution with a true and complete copy (including all annexes) of any amendment to any Project Document or of any Project Document not executed by the Signature Date, within [x] Business Days of the date of the Private Party's execution of such amendment or Project Document.[90]

88 Treasury Regulation 16.8.2.

89 The assignment by the Private Party of any of its rights and/or obligations under any Project Document without the prior agreement of the Institution is also prohibited. This is dealt with in Part S:83.1 (*Miscellaneous: Assignment*).

90 Any Project Documents to be executed after the Signature Date should be disclosed in the Schedule to the PPP Agreement listing the Project Documents, and should be in the Agreed Form.

4.3 Due Diligence

4.3.1 Introduction

4.3.1.1 Although the Institution should not seek to micro-manage the implementation of the Project by a Private Party, it must nevertheless ensure that it understands how the Private Party intends to deliver the Project Deliverables in terms of its subcontracting and financing arrangements and be satisfied that those arrangements (as reflected in the relevant Project Documents) are adequate to allow the Private Party to deliver the Project Deliverables.

4.3.1.2 Accordingly, the Institution should (through its advisors) conduct a thorough ongoing due diligence on all the proposed Project Documents at the bid evaluation phase and during the negotiations with the successful bidder until their execution. This is essential for several reasons including the following:

(a) the amount of compensation payable to the Private Party on termination may in certain circumstances (for example, an Institution Default) take into account certain amounts (or a portion thereof) owed by the Private Party to the Lenders under the Financing Agreements. The Institution must review the Financing Agreements to establish how these amounts are calculated;[91]

(b) the amount of compensation payable to the Private Party may in certain circumstances (for example, an Institution Default) take into account Equity and/or Shareholder Loans. If so, the Institution should review the

[91] See Part N: (*Termination*) for a description of the circumstances when the compensation payable to the Private Party upon termination will take Debt into account.

Shareholders Agreement to establish how the amounts included in it are calculated;[92]

(c) where the Institution relies on the requirements of the Lenders under the Financing Agreements for protection in relation to certain risks (for example, in the case of maintenance risk, the Lenders' requirement for financial provisions for the ongoing maintenance of the Facilities through a maintenance reserve account or for ongoing asset replacement through an asset replacement account), the Institution should ensure that the terms of the Financing Agreements reflect the Institution's expectations;

(d) where the Institution seeks to retain the right to assume the Subcontracts in the event of the termination of the PPP Agreement, the Institution should examine the terms of the Subcontracts to ensure that they permit such assumption. This is particularly important where the Institution wishes to ensure the continuity of service provision under the Subcontracts in circumstances where the PPP Agreement is terminated and these Services are critical. Adequate provision for such rights in favour of the Institution in the Subcontracts themselves will avoid the need for direct agreements between the Institution and the Subcontractors;

(e) to ensure that the Financing Agreements and Shareholders Agreement are consistent with the agreed Financial Model; and

(f) to ensure that the Financing Agreements and the Shareholders Agreement are consistent with the provisions of the PPP Agreement dealing with Refinancings.

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92 See Part N: (*Termination*).

4.3.1.3 The Institution (with the assistance of its insurance advisor) should also review:

(a) the policies relating to the Project Insurances to ensure that they are consistent with the agreed insurance requirements for the Project and that they contain no endorsements, exclusions, excesses or deductibles that are not market standard; and

(b) the letters of the broker appointed to place the agreed Project Insurances so as to ensure that the broker's undertakings referred to in Part I: (*Insurance*) are incorporated in them.

4.3.2 Financing Agreements and Shareholders Agreement

4.3.2.1 The Institution should require copies of the Financing Agreements and the Shareholders Agreement (in final Agreed Form, as these agreements are unlikely to be executed before the Signature Date of the PPP Agreement) of the preferred bidder in advance of the Signature Date to allow it sufficient time to conduct its due diligence.

4.3.2.2 In the due diligence, the Institution should assess and seek advice from its advisors concerning, among other things:

(a) *interest margins* – in particular, whether these agreements make provision for changes in the margins on interest rates. Any changes in the margins should be consistent with those contemplated in the Financial Model;

(b) *fees and costs* – any (i) breakage (that is, unwinding) fees, penalties, premiums and costs for early prepayment of the Debt; (ii) costs (including related breakage costs) relating to any hedging arrangements (including, among other things, any swaps, options, floors and caps) to mitigate against interest rate and foreign exchange fluctuations;

(iii) commitment, underwriting, arrangement, structuring or other fees payable to the Lenders (or to the arrangers of the financing made available to the Private Party or to the Lenders' agents). If the termination compensation will include any fee, penalty, premium or cost as contemplated above, then the Institution must seek advice as to whether it (and the amount thereof) is market standard, competitive and cost-effective and as to how it is calculated.[93] The Institution should also review all hedging arrangements in respect of these costs to ensure that the Private Party has adequately hedged against its exposure to any interest rate and foreign exchange fluctuations;

(c) *maintenance and other reserves* – the Lenders' requirements in respect of the funding of any cash reserves to be put in place by the Private Party (including, for example, any maintenance reserve account or asset replacement account) and the levels required to be maintained in these reserves. The Institution should confirm that upon termination of the PPP Agreement all these reserves will be applied in reduction of the amount of the Debt for the purpose of calculating the termination compensation (so that the Private Party and its funders will not obtain a double recovery) and, further, in the case of any Refinancing (other than an Exempt Refinancing) that the release of any of these reserves will be caught in the sharing mechanism;

(d) *intercreditor arrangements* – the intercreditor arrangements between the Lenders and/or the Shareholders should not undermine any principles agreed

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[93] As regards which fees, penalties, premiums and costs may be incorporated into the termination compensation, see Part N:64 (*Termination: Compensation on Termination for Institution Default*) and Part N:66 (*Termination: Compensation on Termination for Force Majeure*).

to in the PPP Agreement, particularly in relation to the PPP Agreement provisions concerning the payment and amount of any termination compensation;

(e) *letters of credit* – the Private Party's rights pursuant to the Financing Agreements to maintain reserves through the provision of letters of credit or to withdraw the proceeds of any reserve accounts and replace them with letters of credit should be considered. The Institution must ensure that (i) the benefits of any such letters of credit are taken into account in the calculation of any termination compensation and in the sharing of any gains deriving from any Refinancing (other than an Exempt Refinancing), (ii) the amounts capable of being claimed under any letters of credit are set off against the termination compensation to be paid by the Institution to the Private Party (so that the Private Party and its funders will not obtain a double recovery), and (iii) the letters of credit do not automatically terminate on termination of the PPP Agreement (automatic termination will result in the Institution paying a higher compensation amount). Accordingly, the Institution should require a pre-agreed form of letter of credit to be used if the Financing Agreements require reserves to be maintained through the provision of letters of credit or permit reserve accounts to be replaced with letters of credit;

(f) *BEE arrangements* – the Shareholders Agreement should be reviewed for consistency with the obligations undertaken by the Private Party in its bid proposal and the PPP Agreement in respect of any Black Equity and the participation by Black People in the Management Control of the Private Party.[94] For instance, the Institution should obtain advice regarding whether the Shareholders Agreement provides adequate protection against the dilution of the minimum Black Equity required for the Project from time to time if any capital calls are made by the Private Party;[95]

(g) *Equity structure* – the shareholdings in the Private Party should be consistent with the ownership and control arrangements set out in the Private Party's bid proposal. Any security interests taken over the Equity (not limited to Black Equity) should also be considered for their implications in relation to the change in shareholding restrictions contained in the PPP Agreement (see Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*)); and

(h) *Security* – it may be appropriate for the Institution to allow the Private Party to grant the Lenders security interests in certain tangible Project Assets to be furnished by the Private Party over the Project Term.[96] This will depend on whether the granting of such security interests will provide better value for money and on whether these Project Assets will be needed by the Institution for the continued availability of the Services after the end of the Project Term. The Institution must ensure that the RFP identifies all Project Assets or categories of Project Assets that the Institution will require at the end of the Project Term so that this can be taken into account by the bidders in their

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94 The terms "Black Equity", "Black People" and "Management Control" are defined in Part M: (*Black Economic Empowerment*).

95 The authenticity of the beneficial ownership by Black Enterprises of equity in the Private Party and the Subcontractors as well as the authenticity of the status of these enterprises as "Black Enterprises" must be established at the bid evaluation phase and confirmed before the signing of the PPP Agreement. See Part M: (*Black Economic Empowerment*) and Module 2: Code of Good Practice for BEE in PPPs.

96 It is never appropriate for the Institution to agree to grant to the Lenders or to any third parties security interests over any Institution Assets (including the Project Site) included in the Project Assets.

assessment of the security package and the calculation of their bid prices.[97] The Lenders may then be permitted to take security over the remaining Project Assets. The Institution must also ensure that the Project Documents make provision for the release of any such security when the Debt is discharged.

4.3.3 Subcontracts

4.3.3.1 Bearing in mind that the Private Party must bear the risks of subcontracting any part of the Project Deliverables and, further, that the provision of any subcontracted Services should reflect what is available in the market, the Institution should nevertheless review the Subcontracts prior to the Signature Date to ensure that what the Subcontractors will provide in terms of the Subcontracts is reasonably likely to meet the output specifications of the PPP Agreement and that the price of any such Subcontract is consistent with the price for that Subcontract set forth in the Financial Model.

4.3.3.2 The Institution's main concerns in relation to the Subcontracts should be the following:

(a) *term of Operations Subcontract* – the term of this Subcontract should match the Service Period;

(b) *expertise, experience and responsibility* – since the Private Party is an SPV with no track record of service delivery, the Institution must be satisfied that each Subcontractor has the necessary expertise and experience to deliver the part of the Project Deliverables subcontracted to it.[98] The Institution must also satisfy itself that the Subcontracts are

[97] See Module 5: PPP Procurement.

[98] The expertise and experience of the Subcontractors should be established at the bid evaluation phase and confirmed when Subcontracts are finalised.

consistent with the terms proposed in the Private Party's bid proposal and the PPP Agreement, that they impose responsibility on each Subcontractor to perform its subcontracted obligations and that the Private Party has real recourse to each Subcontractor in the event that it defaults under its obligations in the Subcontract. Here, the Institution should identify any limitations in the Subcontracts on the liabilities of Subcontractors to perform their obligations in terms of the Subcontracts;

(c) *replacement of Subcontractors* – the Institution must reserve the right in the PPP Agreement to approve the selection of any replacement Subcontractors applying the same criteria applied in the selection of the initial Subcontractors (such as appropriate expertise, experience and responsibility);[99]

(d) *amendments to Subcontracts* – the Subcontracts should record that any amendments to those Subcontracts will require the prior written agreement of the Institution;

(e) *liquidated damages* – if the PPP Agreement requires the Private Party to pay liquidated damages to the Institution for late delivery of any subcontracted Project Deliverables, then the Institution should ensure that these damages are payable out of amounts available under the relevant Subcontracts (subject to the claims of the Lenders). This is important because if the terms of the PPP Agreement and Subcontracts are materially different, then the Institution could be exposed if the Private Party cannot claim from the Subcontractor responsible for the relevant Project Deliverables; and

[99] See Part S:83.2 (*Miscellaneous: Subcontracting*).

(f) *BEE arrangements* – the Subcontracts should be reviewed for consistency with the obligations undertaken by the Private Party in its bid proposal and the PPP Agreement in respect of the participation by Black Enterprises at the subcontractor level, the participation by Black People in the Management Control of the Subcontractors, employment equity, skills development and procurement opportunities for SMMEs.[100]

5 SCHEDULES

5.1 PPP Agreements usually include several attachments and annexures (referred to in this Standardisation as "**Schedules**").

5.2 These typically set out:

5.2.1 the Financial Model (usually in disk format);

5.2.2 the executed Project Documents or, if not executed by the Signature Date, the Agreed Forms of any such Project Documents;

5.2.3 the Institution's output specifications (which will have formed part of the RFP);

5.2.4 the Works programme and scope of Works;

5.2.5 the Services to be provided by or on behalf of the Private Party;

5.2.6 the Project Site description unless the description is included in a Project Site Agreement;

5.2.7 the list of any Institution Assets;

5.2.8 the performance monitoring regime;

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[100] The terms "Black Enterprise", "Black People", "Management Control" and "SMME" are defined in Part M: (*Black Economic Empowerment*).

5.2.9 the payment mechanism including the definitions of "Performance Deductions" and "Availability Deductions";

5.2.10 the formula for the rebasing or recalculation of CPIX;

5.2.11 the Consents relating to the Project;

5.2.12 the list of the Project Insurances (including a statement of the material terms thereof) and the broker's letter confirming the placement of the Project Insurances;

5.2.13 the incorporation details of the Private Party (including copies of its certificate of incorporation and certificate to commence business) and its capital structure and shareholdings;

5.2.14 the prescribed form of Availability Certificate, the Completion Certificate and any other certificate provided for in the PPP Agreement;

5.2.15 the handback procedure;[101] and

5.2.16 the detailed BEE targets, including the Private Party's skills development plan.[102]

6 PROJECT DELIVERABLES

6.1 The scope and extent of the Project Deliverables are project-specific and will be based on the specific strategic and operational objectives which the Institution wishes to attain as reflected in its output specifications.

6.2 The approach prescribed in this Standardisation is that the Private Party shall bear all the risks associated with the performance of the Project Deliverables which the Institution does not expressly assume. This must be reflected in the PPP Agreement as an express undertaking by the Private Party to exercise its rights and perform its obligations included in the Project Deliverables at its own risk save as otherwise expressly provided in the PPP Agreement.[103]

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101 See Part N:62 (*Termination: Handback*).

102 See Part M: (*Black Economic Empowerment*).

103 See the Standard Clause below.

6.3 Although the risks associated with the performance of the Project Deliverables reside with the Private Party and not the Institution (save to the extent expressly assumed by the Institution), the successful implementation of this risk allocation depends largely on the clarity of the output specifications and the Parties' co-operation in the implementation of the Project Deliverables. Accordingly, the Institution should ensure that the output specifications included in the RFP are clearly drafted and that the PPP Agreement makes provision for co-operation.

Standard Clause

Project Deliverables

(a) *Private Party*

(i) *Subject to, and in accordance with, the provisions of this PPP Agreement, the Private Party shall exercise its rights and perform its obligations included in the Project Deliverables at its own cost and risk without recourse to the Institution save as otherwise expressly provided for in this PPP Agreement.*

(ii) *Without limiting Clause (i), the Private Party shall at its own cost and risk be solely responsible for procuring that the Project Deliverables are performed:*

(aa) *in accordance with Good Industry Practice;*

(bb) *in a manner that is not likely to cause death, injury to health or damage to property or the environment;*

(cc) *in a manner that is consistent with the Institution discharging its statutory functions and duties;*[104]

(dd) *in compliance with all applicable law and the Consents; and*

(ee) *to achieve the [output specifications] for the Project set forth in Schedule [x]*[105] *in accordance with this PPP Agreement.*

(b) *Co-operation*

Each Party shall co-operate with the other in the exercise and performance of their respective rights and obligations under this PPP Agreement.

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[104] This is particularly important in the case of hospital projects where clinical service provision by the Institution must not be hindered or prevented by the manner of conduct of the Project Deliverables.

[105] This refers to the Institution's output specifications (which will have formed part of the RFP).

PART C: GENERAL OBLIGATIONS

7 GENERAL OBLIGATIONS AND RESPONSIBILITIES OF PRIVATE PARTY

7.1 As indicated above, it is assumed in this Standardisation that the Private Party will be an SPV and, accordingly, will not engage in any business or activities not included in the Project Deliverables. If, in a particular Project, the Private Party is entitled to engage in any non-project activities on the Project Site or to use any other Project Assets for purposes not related to the Project, then the provisions of the PPP Agreement dealing with its general obligations and responsibilities will have to be amended accordingly and, in particular, to ensure that the Project is not prejudiced (by the diversion of Project Assets or the non-availability of the Services) as a result of such non-project activities.

7.2 It is also assumed that the Private Party will subcontract the Project Deliverables to the Subcontractors.

7.3 These assumptions are reflected in the following Standard Clause.

Standard Clause

<u>*General Obligations*</u>

(a) The Private Party shall not engage in any business or activity other than the business or activity included in, or otherwise required to enable the Private Party to provide, the Project Deliverables.

(b) The Private Party shall not be relieved of any obligation, responsibility or liability under this PPP Agreement by the appointment of any Subcontractor to carry out any part of the Project Deliverables. As between the Private Party and the Institution, the Private Party shall be responsible for the payment, performance, acts, defaults, omissions, breaches and negligence of all Subcontractors. All references in this PPP Agreement to any performance, payment, act, default, omission, breach or negligence of the Private Party shall be deemed to include any of the same by a Subcontractor.[106]

[106] This Standard Clause reflects the prescribed allocation of Subcontractor risk (that is, the risk of losses or damages arising as a result of defaults on the part of any Subcontractor or its insolvency) to the Private Party. The Private Party will, in turn, pass any risks associated with the performance of any part of the Project Deliverables by any Subcontractor down to the relevant Subcontractor. For instance, in the case of any design risks or completion risks to the Construction Subcontractor and other "first-tier" construction Subcontractors (if any) such as the quantity surveyor by obtaining indemnities or some form of security such as construction guarantees or cessions in security of the proceeds of any insurance to be taken out by the Subcontractors. Notwithstanding this, prior to the Signature Date the Institution should satisfy itself following a review of the Subcontracts that the subcontractor risks are appropriately allocated as between the Private Party and the Subcontractors. See Part B: (*Project Documents and Project Deliverables*).

8 WARRANTIES

8.1 Introduction

8.1.1 In this Standardisation, "warranty"[107] is used to mean a statement confirming the truth of the matters mentioned in it as at the Signature Date.[108] A breach of a warranty in the PPP Agreement should not give rise to any right on the part of the defaulting Party to rescind or otherwise terminate the PPP Agreement, save in the case of warranties relating to Corrupt Acts.[109] Instead, a breach of warranty should give rise only to a claim for damages under the indemnity provisions of the PPP Agreement (within the limits referred to herein and subject to an obligation on the part of the aggrieved Party to mitigate the consequences of the breach), save in the case of a breach of the warranties relating to Corrupt Acts where termination is also permitted.[110]

8.1.2 The Private Party warranties in the Standard Clause below set out the minimum warranties that will ordinarily be sought by the Institution. The Institution should consider at the time when the RFP is being prepared and also at the bid evaluation phase whether any additional warranties should be sought. For instance, additional warranties may be required from the Private Party in connection with any Intellectual Property included in the Project Assets.[111]

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107 Although the concept of "warranty" is widely used and accepted in practice, it has no generally accepted meaning in South African law. Accordingly, contracting parties should always ensure that their contract clearly spells out what the intended purpose and effect of any "warranties" are, particularly if breached.

On the other hand, concepts such as "representation" (or, more correctly, its obverse "misrepresentation") and "term" when used in a contractual setting do have generally accepted legal meanings and their use in a contract usually permits specific remedies (including, rescission or cancellation), unless the contracting parties have agreed to vary the remedies ordinarily associated with these concepts.

To avoid confusion, the Standardisation prescribes the use of "warranty" over "representation" (and any other concepts such as "covenant", "undertaking", and so forth) when referring to any circumstances that exist or ought to exist as at the Signature Date (or any other specific date) and on which either Party is relying to be true as at that date, and further that the intended purpose and effect of any "warranty" be clearly spelt out in the PPP Agreement.

108 If the PPP Agreement includes suspensive conditions, then the warranties should be given both as at the Signature Date and the Effective Date.

109 See Part N:60.5 (*Termination: Termination for Corrupt Acts*).

110 See Part N:60.5 (*Termination: Termination for Corrupt Acts*).

111 See Part R:82.2 (*Intellectual Property: Infringement*).

8.1.3 In order to show its good faith and give the Private Party some measure of comfort, the Institution should consider on a project-by-project basis whether to warrant that it has not knowingly omitted to disclose any material information[112] in its possession or under its control relating to any Institution Assets.

8.1.4 Any other warranties (save as provided in Section 8.1.5) to be given by an Institution must be justified on a project-specific basis. For instance, in the case of "information warranties" in Projects where the Private Party is taking over existing Facilities and Services, warranties regarding such Facilities and Services may be given by the Institution where the Institution is the only source of information and that information cannot be independently verified. All warranties given by an Institution should be drafted with extreme care and limited appropriately.

8.1.5 Where the Institution is not the only source of any information or that information can be independently verified, the Institution must not give any warranties regarding that information. Instead, the Private Party should be required to rely on the results of its due diligence and on any independent surveys made available by the Institution. If no information warranties are to be given by the Institution, then the PPP Agreement should expressly record this and, in addition, provide that the Private Party shall be solely responsible for identifying all information necessary for the performance of the Project Deliverables.

8.1.6 Warranties from either Party in relation to capacity and authority provide no real benefits since, if any such warranty is untrue, the remedies for breach of warranty in the PPP Agreement will have no significance as the PPP Agreement will not be capable of being enforced. Nevertheless, the Institution should warrant its capacity to enter into the PPP Agreement and the authority of its accounting officer or accounting authority, as the

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[112] This warranty (if given) may, for instance, extend to the information obtained by the Institution in the course of its due diligence on the property rights in respect of the Project Site (See Part D:11 (*Project Site: Nature of Land Interests*)) and its site condition surveys (see Part D:12 (*Project Site: Condition of Project Site*)).

case may be, to execute the PPP Agreement on its behalf in order to provide the Private Party (and its funders) with some measure of comfort.

Standard Clause

Private Party Warranties

The Private Party warrants that:

(a) it has taken all necessary actions to authorise its execution of this PPP Agreement;

(b) all the Project Documents have been duly executed on proper authority and are in full force and effect as at the Signature Date, save for those Project Documents identified in Schedule [x] that will be executed in the Agreed Form after the Signature Date by the corresponding date in Schedule [x];[113]

(c) the execution and performance of any Project Documents do not and will not contravene any provision of the memorandum or articles of association of the Private Party[114]*as at the Signature Date, or any order or other decision of any Responsible Authority or arbitrator that is binding on the Private Party as at the Signature Date;*

(d) all Consents required for the conduct of the Project Deliverables are in full force and effect as at the Signature Date, save for any Consents which are not required under applicable law to be obtained by the Signature Date; provided that the Private Party warrants that it knows of no reason (having made all reasonable enquiries in this regard) why any such Consent will not be granted on reasonable terms by the time it is required to obtain such Consent;

(e) no litigation, arbitration, investigation or administrative proceeding is in progress as at the Signature Date or, to the best of the knowledge of the Private Party as at the Signature Date having made all reasonable enquiries, threatened against it, which is likely to have a material adverse effect on the ability of the Private Party to conduct the Project Deliverables;

(f) the Private Party is not subject to any obligation, non-compliance with which is likely to have a material adverse effect on its ability to conduct the Project Deliverables;

(g) no proceedings or any other steps have been taken or, to the best of the knowledge of the Private Party having made all reasonable enquiries, threatened for the winding-up or liquidation (whether

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113 As a general rule, the Institution should endeavour to ensure that all Project Documents are executed at the same time as the execution of the PPP Agreement. If this is not practical, then the Institution must ensure that the Project Documents in question are in final Agreed Form by the Signature Date and, in any event, that the later execution of them will not delay the running of the Project Term.

114 Appropriate amendments will need to be made if the Private Party is not a company.

voluntary or involuntary, provisional or final), judicial management (whether provisional or final) or deregistration of the Private Party, or for the appointment of a liquidator, judicial manager or similar officer over it or over any of its assets;

(h) *all information disclosed by or on behalf of the Private Party to the Institution at any time up to the Signature Date and, in particular, during the bid process preceding the award of this PPP Agreement to the Private Party, is true, complete and accurate in all material respects and the Private Party is not aware of any material facts or circumstances not disclosed to the Institution which would, if disclosed, be likely to have an adverse effect on the Institution's decision (acting reasonably) to award the PPP Agreement to the Private Party;*

(i) *the copies of the executed Project Documents, which have been delivered to the Institution, are true and complete copies of such Project Documents and there are no other documents replacing or relating to any such Project Documents, which would materially affect the performance of these Project Documents; and*

(j) *as at the Signature Date:*

(i) *the Private Party has an authorised and issued share capital as set out in Schedule [x] and all shares in the issued share capital of the Private Party are fully paid up;*

(ii) *all shares in the issued share capital of the Private Party are legally and beneficially owned as represented in Schedule [x];*

(iii) *save as provided in the Financing Agreements or the Shareholders Agreement, no person has the right (whether actual or contingent) to call for the issue of any share or loan capital in the Private Party whether pursuant to any option or otherwise including on realisation of security; and*

(iv) *save as provided in the Financing Agreements or the Shareholders Agreement, there is no encumbrance over or affecting any of the Equity or the Shareholder Loans and there is no agreement or commitment to grant or create any such encumbrance.*[115]

Institution Warranties

The Institution warrants that:

(a) *it has taken all necessary actions to authorise the execution of this PPP Agreement; and*

[115] See also the Standard Clause in Part N:60.5 (*Termination: Termination for Corrupt Acts*), which includes a warranty relating to Corrupt Acts.

(b) *it has not knowingly omitted to disclose any material information in its possession or under its control relating to the Institution Assets.*

8.2 **Institution Warranties and Existing Facilities or Services**

8.2.1 The following commentary deals with the specific issue of Institution warranties where existing Facilities or Services are taken over by the Private Party.

8.2.2 If a Project entails the transfer to the Private Party of existing buildings or infrastructure which require substantial refurbishment and repair, the Private Party will be unlikely to assume any risk of latent defects in these Institution Assets and will probably require warranties from the Institution as to their condition. This is particularly the case in Projects where the existing buildings or infrastructure were constructed and operated according to out-of-date building and environmental standards.

8.2.3 If the PPP Agreement requires the transfer of employees of the Institution to the Private Party, the Private Party will probably require Institution warranties regarding the scope of any pre-Agreement liabilities for pensions and other employment benefits, given that these liabilities are not always capable of accurate calculation and given the legal protections afforded to employees as against new employers.[116]

8.2.4 Since bidders base their bids (including their bid prices) on the information made available by the Institution, the Institution should consider that a blanket refusal to give any of the above warranties might discourage the submission of bids (particularly if the cost of the bidders' due diligence is likely to be exorbitant) and thereby reduce the competitiveness of the tender, or might result in bid prices that are unaffordable and do not provide value for money. The Institution should

[116] This is because of the statutory liabilities imposed on new employers pursuant to section 197 of the Labour Relations Act, 1995. This section provides that where a business is transferred as a "going concern" the rights and obligations of the old employer (the "transferor") are *automatically* assumed by the new employer ("transferee"), which as between it and the transferring employees effectively steps into the shoes of the transferor. Therefore, by operation of law, the transferee assumes *all* liabilities of the transferor under employment contracts in respect of any period preceding the transfer date. The particular exposure of the transferee here is in respect of the accrued pre-transfer benefits of transferring employees. In this regard, see Part L: (*Employment*).

always consider whether it can obtain better value for money (taking into account the overall risk allocation of the Project) if it is able to give these warranties.

8.2.5 If the Institution is unwilling to give any of the warranties contemplated above because it is unsure about the accuracy of its information, then the Institution must (at its cost) arrange for the appointment of independent consultants who have the appropriate expertise and experience to undertake surveys in order to verify such information.[117] Such surveys should be commissioned at the feasibility study phase, on the basis that the full results thereof will be disclosed to all the bidders and ultimately be for the benefit of the Private Party who will be entitled to rely thereon. Given that the results of such surveys are made available to all the bidders and as the Private Party will have recourse to the independent consultant, the Institution need not warrant the accuracy of such results. If the bidders require additional surveys to be undertaken (whether by the same or by another independent consultant), then the Institution should commission these surveys on the same basis, but at the cost of all the bidders (to be shared equally among them) unless the Institution will achieve better value for money if it assumes the whole or a portion of these costs. If the Institution's information cannot be independently verified as aforesaid, then the Institution may consider warranting that information, provided this will result in better value for money.

8.2.6 If the Institution is confident about the accuracy of its information, then it may consider warranting the accuracy of such information, unless that information can be easily verified by the bidders themselves without them incurring substantial costs.

8.2.7 The Institution should, however, be careful that its warranties do not extend beyond what is reasonable in the circumstances. In particular, the Institution should not provide warranties in respect of risks that are

[117] The costs (or reasonable estimates thereof) of the independent surveys should be disclosed in the affordability assessment included in the feasibility study accompanying the Institution's application for TA:I.

covered by the Project Insurances which the Private Party has agreed to procure. In this regard, the Institution should bear in mind that the costs of these Project Insurances will be passed to the Institution through the Unitary Payment.

9 INDEMNITIES AND CLAIMS FOR DAMAGES

9.1 Private Party Indemnities

9.1.1 The Institution will want to ensure that the PPP Agreement requires the Private Party to indemnify the Institution against certain losses that may be incurred by the Institution as a result of the Private Party's performance or non-performance of the Project Deliverables. The Private Party will usually make provision for such contingent liability in its bid price to the extent that it is not covered by insurance.[118]

9.1.2 Generally, there are five heads of liability against which the Institution should seek to be indemnified by the Private Party to the extent that such liability arises as a result of the performance or non-performance by the Private Party of the Project Deliverables. These are:

9.1.2.1 property damage;

9.1.2.2 breach of statutory duty;

9.1.2.3 death and personal injury;

9.1.2.4 other third party claims;[119] and

9.1.2.5 breach of a Private Party warranty.

[118] The term "indemnity" as used in this Standardisation means an undertaking on the part of the indemnifying party (acting as principal) to compensate or reimburse the indemnified party for certain losses arising in connection with the conduct (whether an act or omission) of the indemnifying party such as a breach of any contractual provision or a breach of any warranty given by it.

[119] See also Part R:82.2 (*Intellectual Property: Infringement*) for a discussion on specific Private Party indemnities for infringements of third party intellectual property rights.

9.1.3 As a general rule, the Private Party's liability under any indemnity should not be capped as this will leave the Institution residually exposed to the extent of such uncapped liability.

9.1.4 Such residual exposure is not acceptable where the Private Party's liability (for example, for property damage) is or ought to be covered by any of the agreed Project Insurances (which are indirectly being paid for by the Institution through the Unitary Payment). Thus the Private Party's liability to the Institution for property damage to be covered by the material damage insurances included in the agreed Project Insurances should not be capped because this insurance should cover the full replacement value of the assets. If the Private Party's liability here is capped, it (or its funders) will receive the benefit of the insurance proceeds in excess of the cap. However, an exception may be made in the case of high value Institution Assets if better value for money will be achieved for an Institution by it agreeing to cap the Private Party's indemnity in respect of these Institution Assets.

9.1.5 The Private Party's liability under its indemnity for the breach by it of its statutory duties should also be uncapped, because this liability should be covered by the agreed Project Insurances.

9.1.6 In the case of third party claims (including for death and personal injury), the Institution will generally be opposed to any cap on the Private Party's liability to the Institution under the indemnity because the Private Party will in any event be exposed to the full extent of any such claim should the third party choose to sue the Private Party directly. Here, the Institution will expect the Private Party to rely on its legal liability insurances. However, it may be difficult for the Parties to gauge the appropriate level of insurance cover for third party claims, and the costs of taking out these insurances at levels that the Parties consider appropriate for the Project may be so high as to impact on the required affordability levels for the Project. The Lenders will also be concerned that if the Private Party's indemnity for such claims is not capped, then they will be exposed to an unquantifiable residual risk exposure to the extent that the insurance cover is inadequate. On the other hand, the Institution will also have an unquantifiable residual risk exposure to the extent that the Private Party's liability is capped.

9.1.7 Therefore, the Institution should carefully consider, having regard to the nature of the Project, whether there is a substantial likelihood of third party claims and whether these claims can be adequately covered by insurance (particular consideration should be given to the likelihood of third party claims for consequential losses). If there is a high risk of substantial third party claims that may not be adequately covered by the agreed insurances, then a cap should not be agreed unless this has a substantially negative impact on the affordability (through increased Unitary Payments) of, and the value for money required to be provided by, the Project.

9.1.8 In the case of breaches of Private Party warranties, the Institution should consider that insurance is likely to be unavailable or, even if available, very costly. If this is the case, then the Institution should consider whether better value for money might be achieved by it if the Private Party's liability under this head is capped at reasonable levels.

9.1.9 The Institution should address the issue of caps in relation to all heads of liability in the RFP and the draft PPP Agreement included therein in order to solicit competition among the bidders. All the bidders must be asked to price for each indemnity on a capped and an uncapped basis and to specify the quantum of any cap they propose. The Institution should bear in mind that setting the Private Party's indemnity exposure at levels where debt service is put at risk may not result in better value for money.

Standard Clause

<u>Private Party Indemnities</u>

The Private Party indemnifies and shall keep the Institution indemnified at all times against all direct losses sustained by the Institution in consequence of:[120]

(a) *any:*

(i) *loss of or damage to property (including, without limitation, any Institution Assets);*

(ii) *breach of a statutory duty arising under applicable law;*

(iii) *claim for or in respect of the death or personal injury of any individual; or*

(iv) *other claim, action, charge, cost, demand or expense,*

(including, without limitation, any legal fees or costs) arising in connection with the performance or non-performance of any Project Deliverables, save to the extent caused by the [gross negligence or][121] *wilful misconduct of the Institution or by a breach by the Institution of an express provision of this PPP Agreement; or*

(b) *any breach by the Private Party of any warranties given by it in this PPP Agreement.*

9.2 **Institution Indemnities**

9.2.1 The Private Party (and its funders) will typically insist that reciprocal indemnities be given by the Institution in favour of the Private Party. However, reciprocity is not appropriate because:

9.2.1.1 the Parties do not have identical or even similar roles in the Project. Typically, the Institution's role is limited to payment of the Unitary Payment and the provision of the Project Site, whereas

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[120] If because of value for money considerations any consequential losses included in any third party claims are to be excluded from the cover provided by these Private Party indemnities, then the reference to "direct losses" should be appropriately qualified. See also footnote 131.

[121] These Private Party indemnities should apply even if the indemnified loss is caused by the negligence of the Institution on the assumption that insurance cover will be available to cover the underlying risks. Depending on the availability and the value for money of such cover, gross negligence on the part of the Institution should also be covered by the indemnity and excluded from the exception.

the Private Party's role involves the construction of the Facilities and the provision of the Services and is far more extensive; and

9.2.1.2 the Private Party should bear responsibility for the manner in, and the methods by, which it chooses to perform the Project Deliverables.

9.2.2 The non- or late payment of the Unitary Payment is covered by specific provisions which allow for the accrual of interest at the Default Interest Rate and, accordingly, no Institution indemnity should be given in this regard. As for the non-availability of the Project Site, the Institution should determine at the feasibility study phase whether this should be a Compensation Event or covered by an Institution indemnity. The choice of compensation mechanism here should be determined on a project-by-project basis.

9.2.3 At the time when the RFP and proposed PPP Agreement are being prepared, the Institution should carefully consider, having regard to the nature of the Project, whether there are any other circumstances peculiar to the proposed Project which would justify the giving of indemnities by the Institution. Whatever these circumstances may be, no indemnities should generally be given by an Institution where the underlying risks in respect of which indemnification is sought may be mitigated by any of the Project Insurances,[122] or where the PPP Agreement specifically provides for other compensation to be paid to the Private Party (for example, under the Compensation Event mechanism). In the case of conduct that would not be covered by these insurances or some other compensation mechanism provided for in the PPP Agreement, indemnities should be given (whether on a capped or uncapped basis) if

[122] The only exception here is in relation to the risk of latent pre-transfer environmental contamination at the Project Site for which indemnities may be given (depending on value for money considerations) even where this risk is covered by any of the Project Insurances.

and to the extent this will achieve better value for money. These indemnities must be carefully drafted.[123]

9.2.4 The Institution must also obtain legal advice regarding its capacity and authority to grant any indemnities in light of the provisions of chapter 8 of the PFMA.

9.3 Direct Losses

9.3.1 Care should be taken to ensure that the losses covered by any indemnities are always limited to the direct losses of the indemnified party. All indirect or consequential losses of the indemnified party, such as loss of profits, loss of use, loss of production, loss of business or loss of business opportunity, should be expressly excluded from all indemnities.

9.3.2 Of course, the indemnified party's direct losses in respect of third party claims might include third party claims for indirect losses (such as the third party's lost earnings or profits). This is partly why the Parties may have difficulty gauging the appropriate levels of insurance cover for third party claims and why the Lenders may insist on a cap for Private Party indemnities in respect of third party claims. Institutions should therefore consider on a project-by-project basis whether or not to exclude third party indirect losses from any indemnity for third party claims.

9.4 Third Party Claims Procedure

With regard to any indemnified third party claim, the PPP Agreement should set out provisions governing the conduct of such claims, pursuant to which:

9.4.1 the indemnifier will be obliged to notify the indemnified of any such claim within a specified period of the indemnifier obtaining any actual knowledge of it;

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[123] The indemnities should clearly exclude any liability on the part of the Institution to the extent caused (whether directly or indirectly) by the Private Party.

9.4.2 subject to the terms of the policy in respect of any Project Insurance, the indemnifier will be entitled to dispute any such third party claim in the name of the indemnified (but at the cost and expense of the indemnifier);[124]

9.4.3 the indemnified will give the indemnifier all reasonable co-operation and assistance in relation to such dispute;

9.4.4 in relation to any third party claim disputed by the indemnifier in the indemnified's name, the indemnifier will be obliged not to bring the name of the indemnified into disrepute, and to keep the indemnified fully informed of the conduct of such claim, and will be prohibited from paying or settling such claims without the prior consent of the indemnified;

9.4.5 if the indemnifier does not exercise its right to dispute the claim in the name of the indemnified, then the indemnified should be entitled to pay or settle such claim;

9.4.6 the indemnified should be entitled to take over the conduct of any claim against its release of the indemnifier from liability under the indemnity in respect of such claim; and

9.4.7 if the indemnified has received an indemnifying amount from the indemnifier and subsequently recovers a sum from the third party, the indemnified should repay the indemnifier to the extent that the sum recovered (plus the indemnifying amount) exceeds the loss sustained by the indemnified.

9.5 **Claims for Damages**

9.5.1 Private Parties typically argue that (save where performance or non-performance of the Services may give rise to any type of liability

[124] The Institution should be cognisant of the reputational risks of litigation being conducted in its name by a third party, such as the Private Party. The provisions of the third party claims procedure in the PPP Agreement must therefore permit the Institution to take over any litigation. However, typical insurance policies do not permit this as insurers usually seek the right to control any litigation. Specific advice on this issue should be obtained from the insurance broker placing the Project Insurances.

contemplated in Section 9.1.2 (that is, death or personal injury, loss of or damage to property, and so forth)) the Institution should not seek to rely on its general damages claim or indemnities to provide remedies for poor or non-performance of the Services during the Project Term. The rationale for this is that the payment mechanism in the PPP Agreement should be structured (based on the "no Service, no Unitary Payment" principle) in such manner so as to ensure that the loss to the Institution arising from poor or non-performance of the Services should be captured by Penalty Deductions which, therefore, should be the sole remedy of the Institution during the Project Term. This means that the payment mechanism in the PPP Agreement ought to operate so as to ensure that, during the Project Term, the Penalty Deductions are a genuine reflection of the losses the Institution will incur as a result of the poor or non-performance of the Services.

9.5.2 However, the Institution should bear in mind that reliance on Penalty Deductions may not compensate an Institution for the losses incurred by it in *all* circumstances. The Institution must therefore be cognisant of any circumstances where its reliance on the Penalty Deductions may be misplaced because the Penalty Deductions will not be available at all (or will be insufficient) to compensate the Institution for its losses.[125] This will be the case in relation to Private Party breaches that occur in the construction or development phase of the Project, that is, before Service Commencement, when Unitary Payments are not yet due, for instance, where because of a delay in the construction of accommodation facilities due to a design fault the Institution is compelled to make alternative accommodation arrangements, such as, extending its lease. The Institution will need to be compensated for any expenses incurred by it in this regard. Here, an Institution may be tempted to rely on a general damages claim to cover its losses.

[125] For instance, in revenue-generating PPPs where the Private Party is compensated through charges collected from third party users.

9.5.3 A general damages claim may, however, not provide better value for money because the quantum of damages likely to be obtained pursuant thereto will not be predictable. This may also impact negatively on bid prices and possibly even discourage the submission of bids. So the Institution should determine (based on value for money considerations) whether the compensatory mechanism for such losses (to the extent not covered by the payment mechanism) should instead take the form of security,[126] liquidated damages, an indemnity or a combination of these.

9.5.4 The exclusion of a general damages claim should also apply to the Private Party, as its losses arising in connection with the Institution's conduct should be covered by other compensation mechanisms in the PPP Agreement such as Compensation Events or Institution Variations. The Private Party's losses arising from breaches by the Institution of its obligations under the PPP Agreement will generally be catered for in the Compensation Event mechanism (unless such breach is covered by any specific Institution indemnities, which may be the case in relation to a breach of the Institution's obligation to provide vacant and undisturbed possession of the Project Site).

9.6 **Post-termination**

On termination for Private Party Default, the termination compensation (even if based on the market value calculation) may not reflect all the Institution's losses (including its indemnified losses). To the extent that these losses are not included in such termination compensation, the Institution's right to claim these losses should continue to be exercisable after termination.

Standard Clause

<u>Limitations on Liability</u>

(a) Save for the Institution's right to claim at any time the amount of any direct losses incurred by it as a result of rectifying or mitigating the effects of any Private Party Default and any other express right of the Institution under this PPP Agreement (including any express right to

[126] See Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*)) .

indemnification), [the sole remedy][127] *of the Institution in respect of any failure in the delivery of the Services*[128] *shall be the operation of the Penalty Deductions in accordance with the payment mechanism provided for in this PPP Agreement.*

(b) Nothing in Clause (a) shall prevent or restrict the right of the Institution to seek any interdict or similar relief, any decree of specific performance or any other discretionary remedies of a court.

(c) [If the Private Party is expressly entitled to any indemnification under this PPP Agreement for any losses incurred by it whether because of the conduct of the Institution or any other cause, then the Private Party's sole remedy in respect of such losses shall be its indemnity and, accordingly, it shall not be entitled to any other remedy for such losses whether pursuant to Clause [x][129] *or otherwise.]*[130]

(d) No Party entitled to any indemnification or other compensation under this PPP Agreement for any losses incurred by it, whether because of the conduct of the other Party or for any other cause, shall be entitled to:

(i) any claim for damages for breach of contract, in delict or on any other basis in respect of such conduct or cause; or

(ii) any claim for indirect or consequential losses (including any loss of profit, loss of use, loss of production, loss of business, loss of business opportunity) incurred by it as a result of such conduct or cause.[131]

(e) The Institution shall not be liable whether in contract, in delict or otherwise, to the Private Party in respect of any negligent act or omission of the Institution, its employees, officials, representatives or guests, which is or ought to be insured against pursuant to the Project Insurances. The Private Party has agreed to this on the basis that it shall mitigate the risks of any such negligent acts or omissions on the part of the Institution by obtaining and maintaining the Project Insurances.[132]

10 DOUBLE RECOVERY AND MITIGATION

10.1 The PPP Agreement must provide that neither Party should be entitled to recover (whether pursuant to an indemnity or otherwise) any loss to the extent that it has already been compensated for that loss whether by way of insurance or otherwise.

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[127] The Institution must carefully assess this limitation in light of a thorough analysis of any financial losses that may not be covered by the payment mechanism.

[128] Clause (a) does not extend to the Project Deliverables relating to the construction phase of the PPP Agreement.

[129] The Clause referred to here is the Clause dealing with Compensation Events.

[130] This Standard Clause should be deleted if no Institution indemnities are given.

[131] Having regard to Section 9.3.1, this Standard Clause may need to be amended to exclude third party consequential losses included in the direct losses of the indemnified party.

[132] See Part I: (*Insurance*).

10.2 Each Party should also be under an obligation to mitigate the consequences of any conduct in respect of which it is entitled to compensation under the PPP Agreement (whether by way of an indemnity or otherwise).

PART D: PROJECT SITE

11 NATURE OF LAND INTERESTS

11.1 Introduction

11.1.1 In the majority of PPPs that involve the construction of infrastructure, the Institution will make land (sometimes with existing buildings and infrastructure located thereon) available to the Private Party. During the Project Term the Private Party will manage the operation and maintenance of such land and infrastructure.

11.1.2 Consideration should always be given to the nature of the interest that the Private Party should have in the land and infrastructure during the Project Term.

11.1.3 The Institution must commission a thorough investigation by appropriately qualified experts of all property rights in, and all title and land use restrictions attaching to, the land (and any improvements thereon) at the feasibility study phase of the Project to ensure that the Project will not be jeopardised due to a late discovery of a third party claim to the land or a land-use restriction that could delay or prevent the construction of the Facilities on the land or interfere with the Private Party's possession of the land.

11.1.4 If this investigation exposes any such claims or restrictions which cannot be resolved or lifted in the feasibility study phase of the Project, then the Institution should opt for another Project Site (repeating the investigation exercise) or, if it does not wish to do so, then it should postpone the procurement phase of the Project until these claims or restrictions are resolved or lifted.

11.1.5 If the Private Party and its funders are concerned about third party interference in the Private Party's possession of the Project Site during the Project Term, they will expect the Institution to agree to the Private Party being compensated for its losses arising from such interference.

The Institution may agree to appropriate compensatory relief (whether in the nature of an Institution indemnity or a Compensation Event) in this regard if this will ensure better value for money.

11.2 **Land Transfer or Purchase**

11.2.1 As part of the Institution's feasibility study for a proposed Project, the Institution should consider:

11.2.1.1 the extent to which it will be required to make land and improvements available to the Private Party so as to allow the Private Party to carry out the Project Deliverables;

11.2.1.2 its ability to make such land and improvements available to the Private Party. Here special consideration should be given to any defects in title including those arising from any land claims registered with the Land Claims Commission;[133]

11.2.1.3 the nature of the legal interest in the land and improvements which the Private Party will acquire pursuant to the PPP Agreement or any ancillary documents;

11.2.1.4 whether any consideration will be payable by the Private Party for such interests or whether such consideration will be provided for through a reduced Unitary Payment; and

11.2.1.5 the extent to which the Institution will require access to or some measure of control over the land and improvements during the Project Term.

11.2.2 If the Project will involve the Institution accessing and using the site (for example, in a hospital project where hospital clinical staff employed by the Institution will require access to the hospital managed and maintained by the Private Party), then the Institution should seek legal advice prior to

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[133] In this regard, a thorough due diligence should be conducted in respect of any title deeds or leases relating to the land and improvements and the land claims register. See Section 11.3 (*Land Claims*).

commencing the procurement process to ensure that the Institution's rights of access and use are properly protected after the Institution Asset is made available to the Private Party.

11.2.3 In a particular Project the Institution may already own (in the sense of having registered title) the land and improvements. In this case, it can transfer an interest in the land and improvements to the Private Party (for instance by way of a lease), while at the same time securing for itself an interest in the land (by way of a sub-lease) which allows it access to and use of the land and improvements for the Project Term of the PPP Agreement.

11.2.4 If the Institution has a lease interest in the land, then it is likely that the consent of the lessor of the land (which could be an individual or a non-governmental entity or, more likely, another organ of state) will be required before the Institution is able to grant any interest in the land to the Private Party. If the nature of the land interest to be granted to the Private Party or to the Institution, as the case may be, is that of lease, and that lease is of a long-term nature (10 years or more), specific consideration should be given on a project-by-project basis to the benefits of registration of that lease in accordance with the provisions of the Deeds Registries Act, 1937.[134]

11.2.5 In some PPPs, it may be necessary for a site over which the Institution has no interest to be obtained. Where the location of a Project Site is critical to the success of the Project and the Institution wishes to acquire legal title in and to any Facilities to be constructed thereon by the Private Party, then the Institution should obtain appropriate interests in the site at the time of the feasibility study phase of the Project.

11.2.6 Where the location of the Project Site is not critical to the success of the Project, the bidders may be encouraged to offer solutions in respect of the land needs of the Project. The Institution should bear in mind, however,

[134] Specific legal advice in this regard should be obtained. The Private Party's funders will probably require the registration of the lease since this improves the Private Party's security of tenure as against third parties.

that it could be faced with the untenable choice of the "best site" versus the "best bid". Furthermore, the bidders' costs of reserving their respective sites may be so great that some may be discouraged from bidding. Accordingly, unless the Institution is confident that such a conflict will not arise and that the bidding competition will not be negatively impacted by a request for site solutions from the bidders, the Institution should avoid this route.

11.2.7 Where land and property owned by the Institution become surplus as a result of the Project and the Institution wishes to sell the land as an incentive for participation in the tender and thereby obtain a better contract price, the Institution must ensure that it complies with the Treasury Regulations dealing with the disposal and letting of immovable property of the Institution (to the extent that these Treasury Regulations are applicable to that Institution) and any other applicable law.[135] The Institution needs to ensure that the inter-relationship between the realisation of proceeds from the sale of surplus land, and the Facilities from which the Services will be delivered during the Project Term, support the overall objectives of the Project and do not prejudice the Institution's position should an event of early termination arise.

11.3 Land Claims

11.3.1 The Restitution of Land Rights Act, 1994 currently affects many areas in South Africa in respect of which land claims have been registered with the Regional Land Claims Commissioner. The cut-off date for the registration of all land claims has passed. Although there is no clear guide for the settlement of such claims, the Act nevertheless does not prohibit development of any land subject to a land claim.

11.3.2 The only legal requirement for development to take place is the publication of a notice in terms of section 11(7) of the Act. In terms of

[135] Treasury Regulation 10.2 requires that the disposal of land and improvements by certain Institutions (whether by way of a sale or lease) must be for market-related value unless otherwise agreed by the relevant Treasury (which is not necessarily the same Treasury as that for the purposes of Treasury Regulation 16). The relevant Institutions subject to these requirements comprise national and provincial departments and constitutional institutions.

that section, notice must be given to the Regional Land Claims Commissioner advising it of the proposed development. Section 11(7)(aA) provides that should the Regional Land Claims Commissioner fail to respond to any such notice within the prescribed period (one month), then no permission is needed from the claimant to proceed with the development in terms of the Act. Provided that one complies with all the other legal requirements for the proposed development there should be no basis for a legal objection to the development. A thorough due diligence of the land claims register for the applicable area should be conducted, and any claims (if there are any) resolved before the application for TA:I.

11.3.3 In order to obtain the protection afforded under section 11(7)(aA) of the Act for a proposed PPP development, Institutions must routinely (at the feasibility study phase of their PPPs) publish their section 11(7) notices. If a response is received indicating the existence of any land claim, the Institution must not proceed to the procurement of the Project until permission has been received for the development to proceed.

11.4 Legal Nature of Land Interests

11.4.1 The legal nature of any land interests that may be granted to a Private Party under a PPP Agreement depends on:

11.4.1.1 the nature of the use rights which the Private Party needs to acquire in order to perform the Project Deliverables; and

11.4.1.2 whether or not the Private Party will be required to pay any consideration for such use rights and, if so, the amount of that consideration.

11.4.2 The terminology used to describe a land-use arrangement (that is, "lease", "concession", "land availability agreement", and so forth) is not decisive as regards the legal nature and treatment of that arrangement.

11.4.3 The essential features of a lease are that:

11.4.3.1 the lessee is granted the rights of use and enjoyment of the leased property, with the corresponding obligation to restore that property to its original form as at the commencement of the lease. If the rights conferred under a contract are wider than such use and enjoyment, that is, they entitle the "lessee" to destroy, appropriate or otherwise dispose of the "leased" property thereby diminishing its original substance, then the contract is not a lease;[136] and

11.4.3.2 the lessee must pay monetary consideration (fixed or otherwise clearly ascertainable) for its rights of use and enjoyment. The absence of this obligation indicates a contract of "loan", not a lease.[137]

11.4.4 Several important legal consequences flow from leases (as opposed to, for instance, concessions or loans), such as:

11.4.4.1 simply stated, the rights of use and enjoyment held by a lessee in occupation of the leased premises are "real" (that is, they are enforceable against third parties, including creditors, of the lessor and subsequent title holders, which means that they survive subsequent changes in ownership of the land) as opposed to "personal" (that is, binding only as against the lessor and not against third parties);

11.4.4.2 long leases (that is, leases with a duration of 10 years or more) must also be registered to ensure that these rights remain "real" over the full duration of the lease, failing which these rights (after 10 years and even if the lessee remains in occupation) will not generally be enforceable against third parties;

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[136] For example, a contract pursuant to which the "lessee" has the right to fell and remove non-self-renewing indigenous trees located in an area is not a lease since these rights diminish the substance of the "leased" area.

By contrast, a contract pursuant to which a lessee has the right to fell and remove a crop of self-renewing trees is a lease because the substance of the leased area is not diminished.

[137] The only exception to this requirement for consideration sounding in money is an agricultural lease, where the consideration may be in the form of an ascertainable portion of the crop produced.

11.4.4.3 if the long lease is in respect of a portion of land, that portion will have to be subdivided. This entails a separation of the portion by way of a diagram that must be approved by the surveyor-general and otherwise meet all conditions for subdivision imposed by the responsible local authority under applicable municipal by-laws;

11.4.4.4 a registered long lease can be specially hypothecated in a deeds registry under a mortgage bond since it is regarded in law as a form of immovable property;

11.4.4.5 the common law security interests of a lessor (that is, a tacit hypothec) in the movables located on the leased premises which become operational when rent is overdue; and

11.4.4.6 the requirement for stamp duties to be paid on leases.

11.4.5 The above legal consequences do not attach to other forms of land-use arrangements such as a concession. There is no generally accepted legal definition of "concession". They are, however, distinguishable from leases in so far as the nature of the rights conferred by them are "personal". Concessions may or may not involve the grant of use rights in respect of land but to the extent that they do, such rights are ancillary to other rights included in the concession. A typical example of a concession is where the concessionaire is granted an exclusive right to carry on a trade (for its own commercial purposes) or operate a service (on behalf of the concessor) in an area, together with an ancillary right to use a piece of land in that area in connection with that trade or operations.

11.4.6 A PPP may of course involve a combination of land-use arrangements including both a concession and a lease. This will depend on the particular circumstances of the PPP in question. The agreement between the Parties regarding the land-use arrangements is typically separate from the PPP Agreement itself and is referred to in this Standardisation as the "Project Site Agreement".

Standard Clause

Project Site Agreement

(a) *Project Site*

(i) *The Private Party shall undertake the Works and deliver the Project Deliverables on the Project Site made available to the Private Party in terms of the Project Site Agreement.*

(ii) *The Private Party shall throughout the progress of the Works and the conduct of the other Project Deliverables have regard for the safety of all persons at the Project Site (whether lawfully or not) to the extent required by law, and shall keep the Project Site, the Works and the Facilities in an orderly state as appropriate in accordance with Good Industry Practice to avoid danger to such persons.*

(iii) *With effect from the Expiry Date, the Private Party's unencumbered interest in the Project Site Agreement shall automatically be assigned to the Institution, without the need for any further formality to give effect to such assignment. The Private Party shall not be entitled to any compensation in respect of such assignment. Notwithstanding the aforesaid, the Private Party shall, on demand of the Institution, duly execute all documents including any variation to the terms of the Project Site Agreement, which may be required by the Institution in connection with such assignment.*

(b) *Compliance with Title Deeds*

The Private Party shall procure that:

(i) *all Project Deliverables carried out at the Project Site by or on behalf of the Private Party whether before, during or after the completion of the Works shall be carried out in a manner that does not breach any conditions of the title deeds of the Project Site; and*

(ii) *there shall be no conduct which gives rise to a right on the part of any person to obtain title to the Project Site or any part of it save in accordance with the terms of this PPP Agreement and the Project Site Agreement.*

11.4.7 The Project Site Agreement should deal with the Private Party's access rights on a non-exclusive basis where the Institution requires access and use rights in respect of the Project Site to provide any core services or otherwise discharge its statutory functions (as in the case of a hospital or other accommodation project). To ensure that the Institution's ability to provide its core services and discharge its functions are preserved, these access rights must be retained even in the event of a breach by the

Institution of its obligations. Here the Private Party should rely on its remedies pursuant to the Compensation Event mechanism.

11.4.8 Even in those PPPs where the Institution does not require access to or use of the Project Site and the Private Party is entitled to exclusive possession of the Project Site, the Institution should be cognisant of the possibility that it may still need to regain access to or even full possession of the Project Site, for example, during an Institution step-in or on early termination of the PPP Agreement.

11.5 Tax Considerations

11.5.1 The nature of the land interest to be granted to a Private Party may impact on any tax benefits that the Private Party may seek in connection with the expenditure incurred by it in relation to improvements to the land.

11.5.2 It is essential that the taxation consequences of the choice of land interest be thoroughly considered and that specialist tax advice in this regard be obtained. This is because any negative taxation consequences (for example, the Private Party's inability to claim allowances) flowing from an Institution's preferred land-use arrangement will influence the bid price and ultimately the value for money afforded by a project.

11.5.3 Notwithstanding that the Institution may for various reasons have a preferred position regarding the appropriate land arrangements for a particular project, the Institution should request comment from the bidders early on in the procurement phase regarding the taxation consequences of the Institution's preferred position.

12 CONDITION OF PROJECT SITE

12.1 Investigations

12.1.1 The Institution must require the bidders to conduct a thorough investigation of the proposed Project Site, including any existing buildings or infrastructure located thereon and site conditions. The site condition investigation should include surveys of the climatic, hydrological, hydrogeological, ecological, environmental, geotechnical, archaeological and palaeontological conditions at the Project Site. The scope and extent of such investigation will depend on the complexity of each bidder's design and engineering proposal for the Works to be erected at the Project Site.

12.1.2 If the Project Site has existing buildings or infrastructure that will be taken over by the Private Party for the performance of the Project Deliverables, then the Institution should be cognisant of any practical limitations that may affect the Private Party's ability to properly investigate the Project Site.

12.1.3 In Projects involving:

12.1.3.1 the take-over and the upgrading, refurbishment and/or repair of an existing building and/or infrastructure that is large and complex; or

12.1.3.2 the construction of a new building and/or infrastructure that is large and complex (for example, if the construction will span several locations not adjacent to one another or a large geographic area, like a rail project),

to be used in the provision of the Services, the costs of these investigations are likely to be so high that the private sector may be discouraged from bidding unless those costs are shared.

12.1.4 In such Projects, the Institution may achieve better value for money if it commissions (at its own cost) some of the surveys that should form part of the bidders' investigations, particularly the structural stability survey (in the case of existing buildings and infrastructure) and the geotechnical survey from appropriately qualified and experienced independent experts, each on the basis that the results of such surveys may be made available to all the bidders and for the benefit of the Private Party. The Institution must ensure that the Private Party will have recourse to the independent experts if such surveys are inaccurate. Such surveys should generally be commissioned and undertaken at the feasibility phase of the Project, and the costs thereof (or a reasonable estimate of such costs) must be included in the affordability analysis required for TA:I.[138]

12.1.5 The key purpose of these feasibility phase surveys is to uncover at the earliest opportunity any site condition problems that may cause regulatory delays in the implementation of the Project or that could have such a significant impact on the cost structure of the Project that its affordability and value for money may be negatively affected. These surveys should therefore assist the Institution in determining whether or not its choice of Project Site will help it achieve better value for money.

12.1.6 Should any material site condition problems be discovered at the proposed Project Site and, in spite of this, the Institution still wishes to proceed with the location of the Project at such Project Site, then the Institution must inform the relevant Treasury of these problems. The Treasury is likely to require the Institution to implement mitigation measures satisfactory to the Treasury (including obtaining any necessary Consents from any Responsible Authorities having jurisdiction, or concluding inter-governmental agreements with affected Responsible Authorities to fast-track the resolution of any required Consent applications), before proceeding with the procurement phase of the Project.

12.1.7 Although the results of such surveys should be made available to all the bidders, and the Private Party should be entitled to rely on these results with full recourse to the independent expert if such surveys are inaccurate, nevertheless as between the Institution and the Private Party, the Private Party will remain responsible for undertaking all investigations of the Project Site. The Institution should bear in mind that since the Private Party bears all design and construction risks associated with any Works included in the Project Deliverables, the Private Party should also undertake all such investigations as are

[138] If so requested by the bidders, during the bid phase further surveys may be undertaken on the same basis by independent experts. The costs of these further surveys must be shared equally among all the bidders, unless the Institution can achieve better value for money by assuming the whole or part of these costs.

necessary for it to develop a design and construction proposal that is best suited to the conditions at the Project Site. The Institution should never assume any risk of the Private Party's design and construction proposals being unfit or unsuited for the Project Site.

12.1.8 The Private Party (and its funders) will typically request the Institution to warrant the accuracy of all site condition survey reports made available by the Institution to the Private Party. Such warranties should not be given if the surveys were undertaken by independent experts and on the basis that the results thereof could be relied upon directly by the Private Party for its own benefit.[139]

Standard Clause[140]

Project Site Conditions

*(a) The climatic, hydrological, hydrogeological, ecological, environmental, geotechnical, geological, palaeontological and archaeological conditions of the Project Site (the "**Project Site Conditions**") shall be the sole responsibility of the Private Party. Accordingly, without limiting any other obligations of the Private Party that are included in the Project Deliverables, the Private Party shall be deemed as at the Signature Date to have:*

(i) carried out an investigation of all Project Site Conditions and of any extraneous material in or under the Project Site including its surface, sub-soil and ground water to enable the Facilities to be designed and constructed and the Works to be carried out with due regard for the Project Site Conditions and the seismic activity (if any) in the region of the Project Site;

(ii) for the purpose of such investigation in section (i), inspected and examined the Project Site and surroundings;

(iii) satisfied itself as to the nature of the Project Site Conditions, the surface, sub-soil and ground water of the Project Site, the form and nature of the Project Site, the load-bearing and other relevant properties of the Project Site, the risk of damage to property affecting the Project

139 See also Part C: 8.1.4 to 8.1.6 (*General Obligations: Warranties*).

140 This Standard Clause assumes that the Private Party has been given the opportunity to undertake a thorough investigation of the Project Site and further that the Institution has not assumed any risk in respect of pre-transfer environmental conditions at the Project Site.

This Standard Clause will have to be amended, as appropriate, if and to the extent that the Private Party was not able to undertake a thorough investigation of the Project Site (for example, because of practical limitations related to existing buildings or infrastructure on the Project Site) or the Institution has assumed any risk in respect of pre-transfer environmental conditions at the Project Site.

Site, the nature of the materials (whether natural or otherwise) to be excavated and the nature of the design, works and material necessary for the execution of the Works;

(iv) satisfied itself as to the adequacy of its right of passage over, access to and through the Project Site and any accommodation it may require for the purposes of fulfilling any of its obligations included in the Project Deliverables, such as any additional land or buildings located outside the Project Site;

(v) satisfied itself as to the possibility of interference by persons with rights-of-way across, access to or use of the Project Site with particular regard to the owners and users of any land adjacent to the Project Site; and

(vi) satisfied itself as to the precautions, times and methods of working necessary to prevent or minimise nuisance or interference being caused to any third parties.

(b) To avoid doubt, the Private Party accepts full responsibility for all matters in Clause (a) and the Private Party shall:

(i) subject to Clause [x][141], not be entitled to make any claim against the Institution whether in contract, delict or otherwise[142] on any ground relating to the matters in Clause (a); and

(ii) be responsible for and it indemnifies the Institution against all direct losses sustained by the Institution in consequence of cleaning-up and otherwise dealing with any potentially hazardous materials (being any natural or artificial substance, whether in solid, gaseous or liquid form capable of causing harm to any human or any other living organism supported by the environment (including air, water, land, surface land and sub-surface land) or capable of damaging the environment or public health or posing a threat to public safety including any pollutants and any hazardous, toxic, radioactive, noxious, corrosive or dangerous substances and all substances for which in each case liability or responsibility is imposed under applicable environment law) at the Project Site.[143]

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[141] This must refer to the Clause setting out the Institution's warranty relating to the wilful non-disclosure of information. See the Standard Clause in Part C:8 (*General Obligations: Warranties*).

[142] This refers to the Clauses dealing with Compensation Events.

[143] If the Institution has agreed (in accordance with Part C:9 (*General Obligations: Indemnities and Claims for Damages*)) to cap the Private Party's liability then this Standard Clause must be amended as appropriate.

12.2 **Latent Defects**[144]

12.2.1 In a Project involving the construction of new buildings and/or infrastructure by or on behalf of the Private Party, the Private Party should bear the design and construction risk in respect of those Facilities as well as the risk of latent defects in those Facilities.

12.2.2 In Projects involving the take-over and upgrading or refurbishment of an existing building and/or infrastructure to be utilised by the Private Party in the provision of the Services,[145] where there is no construction guarantee from the original building contractor or such guarantee is insufficient or not transferable to the Private Party, the Institution may be expected to assume the risk of latent defects in the existing building and/or infrastructure.

12.2.3 The Institution should, however, not readily assume such risk. Instead, whether or not this risk should be assumed by the Institution should be decided on a project-by-project basis having regard to the particular circumstances of the Project, including, for example, the length of time for which the existing building or infrastructure has been operational. This decision should always depend on whether the Institution's assumption of such risk will provide better value for money. Thus, for example, an Institution should not readily assume this risk in respect of the structural stability of an existing building or infrastructure that has been operational for a lengthy period without any indication whatsoever of structural instability. On the other hand, where the existing building or infrastructure has not been operational for any substantial period of time and, accordingly, its structural stability has not really been "time tested", the Institution should expect to assume some of this risk (save to the extent that any construction guarantees are still in effect and can be transferred to the Private Party). The sharing of this risk between the

[144] See also Part C:8 (*General Obligations: Warranties*).

[145] Compare this with a project involving the take-over by the Private Party of existing buildings or infrastructure for its own commercial purposes and not for the performance of an institutional function on behalf of the Institution.

Parties may also vary in relation to different parts of the existing building or infrastructure as certain parts may be perceived as having lesser risk of latent defects than other parts.

12.2.4 The Institution should also not assume the risk of latent defects in the Project Site itself (for instance, in relation to subsidence, seismic instability, environmental contamination and so forth). However, in the case of a Project Site to be used by the Private Party in the provision of Services[146] where, because of the nature of historical activities at the Project Site, there is a high risk of environmental contamination at the Project Site, the transfer of the full risk of latent environmental contamination to the Private Party may not result in value for money for the Institution. In such cases, if better value for money will be attained thereby, then the Institution should assume the risk of latent environmental contamination at the Project Site up to the Signature Date.[147]

12.2.5 If an Institution does assume any latent defect risk, it should ensure that the Private Party is under a clear obligation to mitigate the potential effects of this risk. The Institution should also implement (if practicable) the following mitigation measures:

12.2.5.1 it should make the results of all surveys commissioned by it in respect of the Project Site (including existing buildings and infrastructure) available to all the bidders;

12.2.5.2 all the bidders should be given a reasonable opportunity to conduct a thorough investigation of the Project Site (including existing buildings and infrastructure) in order to maximise the possibility of exposure of defects and the extent of any required remediation, although the Institution should be cognisant of the practical difficulties bidders may face in undertaking their investigations on

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146 Compare this with a project involving the take-over by the Private Party of a Project Site for its own commercial purposes and not for the performance of an institutional function on behalf of the Institution.

147 See Section 14.2 *(Environmental Risks)*.

the Project Site where existing buildings and infrastructure are to be retained for the provision of the Services;

12.2.5.3 prior agreement should be reached between the Parties on the scope of the remediation works that will be required to be undertaken to fix identified defects to the satisfaction of the Private Party;[148]

12.2.5.4 the cost of the remedial works for identified defects should be pre-agreed. Any such costs paid for by the Institution must be certified by the Private Party as being sufficient to remove these defects to the satisfaction of the Private Party;

12.2.5.5 the liability of the Institution in relation to latent defects should not be capped if this is necessary to achieve affordable bid prices (as bidders will usually price for the cap through higher bid prices) and value for money for the Institution. It should not, however, be readily assumed that an uncapped liability will necessarily ensure better value for money. Further, the Institution's liability should not be triggered in respect of minor defects discovered after the Signature Date. In other words, the Institution should consider whether value for money requires that its liability be subject to a "floor" (in addition to any cap or no cap); and

12.2.5.6 the Private Party should be under an ongoing obligation to report on the condition of the Project Site and the discovery of latent defects.

12.2.6 The Institution should appoint an independent expert to monitor and report on the bidders' investigations referred to in Section 12.2.5.2 above in order to ensure that these investigations are reasonably thorough. Furthermore, the independent expert should be mandated to monitor and report on the implementation of the remediation works agreed to between

[148] Here the Institution should not be tempted to be prescriptive regarding the remediation works as the risk of implementing such works should be shifted to the Private Party in the PPP Agreement.

the Parties and certify the completion of these works. The principles referred to in Part E:19.2 to Part E:19.4 (*Duration and Service Commencement: Independent Certifier*) in relation to the appointment and duties of, and the limitations on the risks assumed by, the Independent Certifier must apply to the same extent to the independent expert appointed in respect of the remediation works.

13 PLANNING CONSENTS AND RISKS

13.1 In this Standardisation, "planning risks" refers to the possibility that the proposed use of the Project Site in terms of the PPP Agreement and, in particular, the construction of the Facilities on the Project Site, will fail to comply with any applicable laws relating to planning, land-use or building (for example, any town-planning or land zoning scheme) or any Consent required to be obtained pursuant thereto, or that any such Consent will be delayed or cannot be obtained or, if obtained, can only be implemented at a greater cost than originally projected.

13.2 Save as provided in Section 13.5, the prescribed approach in respect of PPPs is that planning risks should be allocated between the Parties as follows:

13.2.1 unless the selection of the Project Site is the responsibility of the Private Party, the Institution should be responsible for obtaining any zoning, re-zoning and/or land-use Consents required for the Project Site.[149] This should be done at the time of the feasibility study phase of the Project and not after the Project has been put out to tender. The costs of these Consents should be included in the affordability assessment forming part of the application for TA:I;

13.2.2 the Private Party should be responsible for identifying and obtaining all planning and building Consents required in connection with the design

[149] The Institution should ensure that the proposed development is in line with the macro-planning policies of any Responsible Authorities having planning jurisdiction over any portion of the proposed Project Site, such as the Integrated Development Plans of any municipalities having jurisdiction.

and/or construction of the Works. The Private Party should make adequate provision for this in its Works programme;[150] and

13.2.3 the Private Party must be responsible for implementing all planning, land-use and building Consents issued in respect of the Project, and complying with all applicable planning, land-use and building laws. The cost of doing so is for the Private Party.

13.3 The obtaining of any of the Consents in Section 13.2.2 by the applicable milestone dates in the Private Party's Works programme must not be a condition suspending the enforceability of the PPP Agreement. In addition, the Private Party's failure to obtain any such Consent by the applicable milestone date should not result in the termination or cancellation of the PPP Agreement (that is, it should not be a resolutive condition) nor should it be treated as a Compensation Event. This is because to do otherwise will result in the Institution taking back the design and construction risks.

13.4 However, if the grant of any such Consent is delayed because of circumstances beyond the control of the Private Party or the Subcontractors, then such delay may be treated as a Relief Event.[151]

***Standard Clause*[152]**

Private Party Consents

(a) The Private Party shall be responsible for:

(i) obtaining all Consents [(other than those listed in Schedule [x])][153] which may be required in connection with the performance of the Project Deliverables;

(ii) maintaining in full force and effect all Consents [(including those listed in Schedule [x])][154]; and

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[150] It is common practice in the construction industry for building contractors to incorporate contingencies into their construction contracts to provide for delays in obtaining any necessary planning Consents.

[151] Accordingly, although the Private Party will get relief from termination for such a delay, it will retain the financial risks associated with such delay (save to the extent that its losses arising from such delay are covered by its project delay insurance). Any debt service due and payable in the period of the delay should be covered by the reserves in the Private Party's debt service reserve account.

[152] This Standard Clause applies to any planning, building, environmental and any other Consents required for the performance of the Project Deliverables.

[153] This Schedule should list all those Consents that have or will be obtained by the Institution as contemplated in Section 13.2.1 and Section 14.1.1.

(iii) implementing all Consents [(including those listed in Schedule [x])][155] *in accordance with their respective terms within the period of their validity.*

(b) The Institution shall provide all such assistance to the Private Party as may be reasonably necessary for the Private Party to obtain all the Consents referred to in Clause (a)(i); provided, however, that the Institution shall incur no liability for the costs of obtaining or maintaining, or any delay, failure or inability of the Private Party to obtain or maintain any such Consents.

13.5 In a PPP where the Private Party will not perform any institutional function but will use state property made available by the Institution solely for its own commercial purposes, all planning risks are for the Private Party.

14 ENVIRONMENTAL CONSENTS AND RISKS

The Private Party is responsible for obtaining all environmental consents required for, and must assume all environmental risks (including for pre-existing environmental contamination) associated with, a PPP where the Private Party will not perform any institutional function on behalf of the Institution but will use state property made available by the Institution solely for its own commercial purposes.

14.1 Environmental Consents

14.1.1 In Projects involving the performance by the Private Party of an institutional function, the Institution should be responsible (at its cost) for conducting any macro-level environmental impact investigation into, assessment of, and reporting to the Responsible Authorities, on the proposed land uses and activities at the Project Site, to the extent required by section 24(7) of the NEMA, unless the selection of the Project Site is the responsibility of the Private Party. Such costs should be reflected in the affordability assessment included in the feasibility study for the PPP that is submitted in the application for TA:I.[156]

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[154] See footnote 153.

[155] See footnote 153.

[156] The construction of a new road through a forest, a new airport and a new prison in areas where there are no similar developments are examples of developments where a macro-level investigation (sometimes referred to as a "**Strategic Environmental Assessment**" or "**SEA**") has to be undertaken to ascertain the cumulative environmental impacts of the proposed development for the general area in which the proposed development will be located. By comparison to an EIA, the SEA is not directed to the specific design parameters of the proposed development and the immediate impact thereof on the

14.1.2 The Institution should not put such a Project out to tender until the investigations and assessments required under NEMA (if applicable) into the potential impact of the proposed land uses and activities on the environment have been completed, reported to, and considered by, the Responsible Authorities. Further, any concerns raised by the Responsible Authorities in response to such report should be dealt with by the Institution in advance of the tender to reduce the scope for any delays in the tender process (and implementation of the Project after the award of the tender) arising from the potential environmental impact of the Project.

14.1.3 On the other hand, the responsibility for conducting any scoping and EIA required pursuant to the ECA for any project should be borne by the Private Party since the EIA is dependent on the design and construction specifications of the Works for which the Private Party is responsible. The Private Party must generally assume all risks associated with any such EIA and should adequately provide in its Works programme for the time it will require to conduct and obtain a record of decision in relation to the EIA. Accordingly, the issue by the Responsible Authority of a favourable record of decision on the EIA should not be a suspensive condition of the PPP Agreement. In addition, the Private Party's (or the Construction Subcontractor's) failure to obtain such decision should not result in the termination or cancellation of the PPP Agreement (that is, it should not be a resolutive condition) nor should it be treated as a Compensation Event. This is because to do otherwise will result in the Institution taking back the design and construction risks. However, a delay in the issue of the record of decision by the applicable milestone date in the Works programme should be a Relief Event (thereby giving the Private Party relief from termination, but not from the financial costs

environment at the specific location of the proposed development. However, an SEA can contribute significantly to the timeous and successful implementation of a Project by reducing the time and effort entailed by an EIA. For instance, if an SEA determines that the proposed route of a new road will have a cumulative detrimental impact on the environment and this determination is made before the Project is put out to tender, the Institution will avoid the wasted time and costs that will arise if the SEA is not undertaken but a similar determination is made pursuant to the EIA undertaken by the Private Party.

of such delay)[157], but only if this delay arises because of circumstances beyond the control of the Private Party or the Subcontractors.

14.2 **Environmental Risks**

14.2.1 The Private Party should bear all environmental risks associated with the performance or non-performance of the Project Deliverables, and should be liable for any risk of environmental damage to the Project Site or third party property arising in connection with such performance or non-performance.

14.2.2 If there is a risk of environmental contamination at the Project Site caused by activities conducted at the Project Site or on adjacent sites before the date on which control of the Project Site is transferred to the Private Party, then the Institution should consider the value for money benefits of compensating the Private Party by way of an indemnity for the direct losses incurred by the Private Party in connection with such contamination. Such indemnity should, however, only extend to any latent pre-transfer environmental contamination discovered within a specified period after the Signature Date. What that period should be, should be determined by the Institution on a project-by-project basis having regard to value for money considerations.

14.2.3 The Private Party may also seek to be indemnified against the losses incurred by it as a result of future environmental contamination at the Project Site arising from ongoing activities at adjacent sites. As between the Institution and the Private Party, the Institution must not assume the risk of such activities and, accordingly, it may not grant any indemnities (or any other compensation) to the Private Party in this regard. The Private Party will have recourse (under the common law, the Constitution and environmental legislation) against the polluter and should rely on the remedies available to it under these laws to recover any such losses.

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157 Any debt service becoming due and payable over the period of the delay should be covered by the reserves in the Private Party's debt service reserve account.

14.2.4 If the Project involves the take over by the Private Party of existing buildings and/or infrastructure which are likely to have caused or contributed to pre-transfer environmental contamination at the Project Site, the Private Party will be exposed to the risk that these may be closed down or the Services compulsorily ceased or adversely restricted by a Responsible Authority in order to stop the continuation of such contamination. The Private Party (and its funders) may seek to be indemnified against the losses incurred by it as a result of such closure, cessation or adverse restriction.

14.2.5 Any indemnities granted by the Institution (whether in the circumstances contemplated in Section 14.2.2 or Section 14.2.4) must be subject to the limitations discussed in Part C:9 (*General Obligations: Indemnities and Claims for Damages*) and Part C:10 (*General Obligations: Double Recovery and Mitigation*). The PPP Agreement must set forth a procedure for the Private Party to notify the Institution of the discovery *after the Signature Date* of any pre-transfer environmental contamination, for the Private Party to present a proposal to the Institution for the remediation of such contamination (including an estimate of the reasonable costs of the remediation works) and for the Parties to negotiate the terms of that proposal. It must also provide for the referral of any disputes in connection with such contamination and the Private Party's remediation proposal to the independent expert referred to in Section 14.2.9. Once the remediation proposal has been agreed (or, if applicable, determined by the independent expert), the Private Party should bear the risks associated with the contamination save for the costs of the remediation works, as agreed or determined by the independent expert, which must be borne by the Institution.

14.2.6 If an Institution wishes to limit the scope of or otherwise avoid the grant by it of any indemnities for latent pre-transfer environmental contamination, then it should during the feasibility study phase commission (at its own cost) environmental surveys of the nature and extent of the on-site contamination and, if feasible, incorporate the remediation of the Project Site into the Project Deliverables and, accordingly, into the output specifications for the Project. The full results of these surveys must be incorporated in the RFP documents and the bidders must be specifically requested to submit proposals for the remediation of the Project Site and to price separately for the costs of such remediation. The bidders should also be required to conduct their own environmental investigation of the Project Site in order to satisfy themselves as to the nature and extent of the on-site contamination identified by the Institution and appropriateness of any remediation works proposed by them. In setting the output specifications for the remediation of the Project Site, the Institution should bear in mind that the minimum legal standard for the remediation of any contamination may not be sufficient for the proper performance of the other Project Deliverables. For example, if the minimum legal standard for the remediation of any environmental contamination is containment as opposed to the removal of the contamination, the Institution should not limit the output to containment, simply because this is less expensive than removal, if the removal of the contamination is necessary for the proper performance of the remaining Project Deliverables. In this regard, the Institution should bear in mind that the minimum legal standards are also likely to fall short of Good Industry Practice with which the Private Party is obliged to comply in the performance of the Project Deliverables.

14.2.7 To avoid the assumption of any risks in respect of the scope and quality of remediation works, the Institution should not be prescriptive regarding the scope or nature of the remediation works, or how such works must be carried out. The Parties must, however, pre-agree the date by when such remediation works must be concluded. The Private Party's remediation programme for the remediation works contemplated in Section 14.2.6 must be incorporated into its Works programme.

14.2.8 The cost of the remediation works in respect of any pre-transfer environmental contamination discovered before the Signature Date and identified in the environmental remediation output specifications, must be pre-agreed and fixed in the PPP Agreement. This will serve to cap the Institution's liability in respect of such contamination.

14.2.9 The Institution should consider appointing an independent expert to monitor and report on the implementation by the Private Party of its proposed remediation works. The independent expert must also be mandated to certify the completion of the remediation works. The principles referred to in Part E:19.2 to Part E:19.4 (*Duration and Service Commencement: Independent Certifier*) in relation to the appointment and duties of, and the limitations on the risks assumed by, the Independent Certifier must apply to the same extent to the independent expert appointed in respect of the remediation works.

14.2.10 The Institution should, at the feasibility phase, consider whether the remediation works should be funded through a capital contribution made at the commencement or completion of those works, or through the Unitary Payment. The choice of payment option will depend on which option provides better value for money. In order to test the value for money benefits of each payment option, the Institution should consider requesting the bidders to bid on all payment options. Since the Unitary Payments only commence once the Services are available, the delay of the payment for the remediation works until then (and its "amortisation" over the whole or part of the Service Period) may not satisfy the cashflow needs of the Private Party.

14.2.11 It is important that the Institution does *not* permit the issue of pre-transfer environmental contamination to cloud the issue of the Private Party's responsibility for environmental risks arising in connection with the performance or non-performance of those Project Deliverables that are unrelated to the remediation of any pre-transfer environmental contamination. In this regard the Institution should ensure that the environmental risks associated with the ordinary operational obligations of the Private Party are not transferred to the Institution through any indemnities given by it in respect of latent pre-transfer contamination or the provisions of the PPP Agreement in respect of identified pre-transfer environmental contamination. The Institution should be particularly concerned that funds allocated for agreed environmental remediation works are not utilised to fund the ordinary operation and maintenance obligations of the Private Party.

15 HERITAGE RESOURCES[158]

15.1 The Private Party must comply with all applicable legislation relating to heritage resources (including all buildings and structures that are older than 60 years and archaeological and palaeontological resources) in the performance of the Project Deliverables. Pursuant to such legislation, a heritage impact assessment will have to be conducted prior to the commencement of any construction or development. Provision is also made in such legislation for the heritage impact assessment to be conducted as part of the EIA required for such construction or development. That legislation also governs the issue of ownership of all heritage resources discovered in the course of conducting any works on land.

15.2 The bidders' site condition investigations must include an investigation of the age and heritage status of all existing buildings and infrastructure at the Project Site. The discovery after the Signature Date that any building or infrastructure at the Project Site is a protected heritage resource and any resultant delays in the Works required for the Project must be neither a Relief Event nor a Compensation Event.

15.3 The bidders' investigations into ground and subsurface conditions at the Project Site must extend to any palaeontological and archaeological conditions. The discovery after the Signature Date of any heritage resource (such as burial grounds of cultural significance) that could have been discovered through the exercise of reasonable due diligence on the part of the Private Party in the course of its investigations should not be a Relief Event or a Compensation Event. The discovery after the Signature Date of any heritage resource that could not be discovered through the exercise of reasonable due

[158] This term refers to all "heritage resources" as contemplated in the National Heritage Resources Act, 1999 (the successor to the National Monuments Act, 1969), and any corresponding provincial legislation.

diligence by the Private Party should be treated as a Relief Event entitling the Private Party to an extension of time, but (save as contemplated in Section 15.4) the financial risks associated with such discovery must be borne by the Private Party. In this regard, see Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*).

15.4 If the discovery of any heritage resource entitles the Private Party to any relief as aforesaid and the Private Party is instructed to undertake any additional works or variation in the Works in connection with such discovery, then the Private Party will be entitled to compensation for such works (which shall be deemed to be an Institution Variation) in terms of the provisions dealing with Institution Variations. If the Private Party is not entitled to any relief as aforesaid, then the additional works or variation in the Works shall be deemed to be a Private Party Variation.

15.5 If any heritage resources are discovered in the course of the surveys commissioned by the Institution at the feasibility study phase, or any investigation conducted by a bidder, then the Institution should endeavour to obtain any necessary Consents for the proposed PPP development from the Responsible Authority before the commencement of the procurement phase (in the case of discoveries made in the feasibility phase) or the Signature Date (in the case of discoveries made in the bid phase). After any such discovery, the Institution should first assess the cost implications for the Project of any actions required by such Responsible Authority in relation to such discovery before proceeding with the Project (or the procurement thereof).

Standard Clause

Heritage Objects and Resources

(a) Discovery

Upon the discovery of any heritage object or resource (as defined in the National Heritage Resources Act, 1999 or any corresponding provincial legislation) during the course of the Works, the Private Party shall:

(i) promptly notify the Institution of such discovery;

(ii) take all necessary steps not to disturb the heritage object or resource, including cease any Works to the extent that the carrying out of such Works might reasonably endanger the heritage object

or resource or prevent or impede its excavation or preservation; and

(iii) take all necessary steps to preserve the heritage object or resource in the same position and condition in which it was discovered.

(b) Action

(i) The Institution shall promptly and in any event within [x] Business Days of the notice in section (a)(i) issue an instruction to the Private Party specifying what action the Institution requires the Private Party to take in relation to such discovery.

(ii) The Private Party shall promptly and diligently comply with any instruction so issued (save to the extent that such instruction constitutes a proposal by the Institution for a deemed Institution Variation as provided in Clause (iv) below, in which case the variation procedure provided for in Clause [x] (Institution Variations) shall apply)[159] *at its own cost.*

(iii) If so directed by the Institution or Responsible Authority, the Private Party shall allow representatives of the Institution or Responsible Authority to enter onto the Project Site for the purposes of removal or disposal of such discovery; provided that such entry shall be subject to the Institution or Responsible Authority complying with all relevant safety procedures which shall include any relevant health and safety plans for the construction of the Facilities and any reasonable directions regarding the safety of the Project Site that may be issued by or on behalf of the Private Party.

(iv) If the discovery is a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities) which are not Works that would be necessary for the purpose of compliance with applicable law or any Consents, then such works shall be deemed to be an Institution Variation and the provisions of Clause [x] (Institution Variation) shall apply.

(v) If the discovery is not a Relief Event and any instruction from the Institution in connection with the discovery includes the requirement for the Private Party to carry out works (being any work of alteration, addition, demolition or extension or variation in the Facilities), then such works shall be deemed to be a Private Party Variation and the provisions of Clause [x] (Private Party Variation) shall apply.

[159] In this regard, see Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

16 UTILITIES AND RESOURCES

16.1 In this Standardisation, "utilities supply risk" refers to the possibility that any utilities such as water, electricity or gas that will be required for any part of the Project Deliverables (not limited to the construction Works) may not be available. Generally, the utilities supply risk should be borne by the Private Party.

16.2 One exception here is where the supply of any such utilities falls within the functional competence of the Institution.

16.3 In addition, where the location of the Project Site is critical (such as the location of a prison) and any required utilities are not available in the vicinity of the Project Site, the Institution may share in some of the utilities supply risks if and to the extent that this will result in better value for money. The value for money benefits of the Institution sharing in these risks should be determined at the time when the feasibility study is undertaken. The Institution should ensure that the RFP clearly stipulates how the utilities supply risk will be allocated as between the Parties so that the Institution can consider how the bidders have priced for that portion of the risk that will be allocated to the Private Party and how such allocation impacts on affordability and value for money.

16.4 This risk-sharing may involve the provision by the Institution (at its cost) of all required connections for the supply of utilities up to the boundary of the Project Site, and the provision of all connections to the Facilities from the boundary of the Project Site by the Private Party (at its cost). The Institution should bear in mind that if it undertakes to provide any required connections for the supply of utilities, a delay by it in the provision of these connections might impact on the Works programme of the Private Party and ultimately the Service Commencement Date. Such delay may have to be treated as a Relief Event. It may even be treated as a Compensation Event, unless project delay insurance is available to cover this risk.[160] In such circumstances, the

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[160] See Part J: (*Relief Events, Compensation Events and Force Majeure*).

Institution should also not be entitled to call on its security (if any) against late Service Commencement.

16.5 Generally, the Institution should not, whether in the circumstances contemplated in Section 16.4 or otherwise, assume any ongoing responsibility for the supply of the utilities after the required connections become operational. Thus off-site and on-site interruptions[161] in the supply of utilities after the required connections become operational should be at the Private Party's risk and should not be treated as Compensation Events (nor should the Institution indemnify the Private Party for losses incurred by it as a result of such interruptions), although the Private Party should get relief from termination in relation to off-site interruptions arising from circumstances beyond its control (that is, such interruptions should be treated as Relief Events).

16.6 If, however, value for money considerations require the Institution to bear some of the risk of interruptions in the utilities supply, this risk may be borne by the Institution but only in relation to off-site interruptions and then only to the extent of an interruption in the performance of the Project Deliverables, by way of relief from Penalty Deductions. In considering whether or not to grant such relief, the Institution should bear in mind that the Private Party's revenue losses arising in connection with interruptions in the supply of utilities might be covered by the project delay or business interruption insurance to be maintained for the Project. The Institution should obtain specific advice on this issue from its insurance advisor.

16.7 Another risk associated with utilities is the risk of delays arising in connection with the removal and relocation of utilities located at the Project Site, for instance, electricity supply lines and associated infrastructure. The erection of construction Works on a Project Site may necessitate the removal and relocation of existing utilities. This is typically undertaken by the utility supplier. Unless the Institution is also the utility supplier, this risk should be

[161] The term "interruption" includes both a failure in the supply of utilities and a shortage in the required volumes of supply.

borne by the Private Party. Where, however, these delays are not attributable to the Private Party, then relief may be granted in the event that Service Commencement is delayed by these delays. Such relief will be in the form of Relief Events and relief from calls by the Institution on its security (if any) against late Service Commencement.

16.8 The input or resource risk (that is, the possibility of a failure in the supply of inputs or resources (for instance, coal and other fuels) required for any Project Deliverables, including any deficiencies in the quantities and quality of such inputs or resources) should generally be borne by the Private Party.

16.9 However, where the Institution is the supplier of such inputs or resources then this risk should be borne by the Institution. In addition, any failure or shortage in the supply of required resources that arises because of circumstances beyond the control of the Private Party should be treated as a Relief Event.

16.10 To mitigate against this risk, the Private Party may enter into "requirements contracts" (often on a "take-and-pay" basis)[162] with suppliers pursuant to which the suppliers (in turn) will assume the risk of any failure in the supply by agreeing to meet the full supply requirements of the Private Party from time to time and to indemnify the Private Party against losses sustained by it if these requirements are not supplied. These contracts should be included in the Project Documents and be reviewed by the Institution in light of the considerations mentioned in Part B: (*Project Documents and Project Deliverables*).

[162] Meaning that the Private Party's obligation to pay for any inputs supplied is conditional upon delivery of the required inputs.

PART E: DURATION AND SERVICE COMMENCEMENT

17 DURATION

17.1 The PPP Agreement must specify its duration. A distinction may need to be made between the period (if any) from the Signature Date to the commencement of the Service Period, and the Service Period itself. It may also be appropriate to specify a "Long Stop Date" for the commencement of the Services, non-fulfilment of which may amount to a breach of the PPP Agreement entitling the Institution to terminate the PPP Agreement.[163]

17.2 The choice of duration should be considered in light of the following factors:

17.2.1 the requirements of the Institution in relation to the Services;

17.2.2 the possibility of alternative uses of the Project Assets;

17.2.3 the affordability of the Services for the Institution in light of its anticipated future budgetary allocations and also the expected useful economic life of the Project Assets. Here, the basic principle is that a longer duration PPP Agreement may be more affordable as this may reduce the amount of the Unitary Payments over the Project Term;

17.2.4 the need for any major refurbishment or replacement programmes in respect of the Project Assets over the Project Term; and

17.2.5 the term of the Debt (a longer debt service period could allow a longer duration).

17.3 One factor influencing a shorter Project Term is where the Project Assets have an alternative use so that the Private Party would be able to recover a portion of the cost of financing its investment in the Project by putting such Project Assets to an alternative use or selling them after the Expiry Date. Here the Unitary Payments should be lower and the Project Term should be shorter than would be the case if the

[163] As the ultimate goal of the Institution is Service Commencement and not termination it is important that the need for a Long Stop Date be carefully considered particularly in relation to value for money. This issue should be considered at the feasibility study phase. In this regard see Module 4: PPP Feasibility Study.

Project Assets had no alternative use. This assumes, however, that the Institution will not require the Project Assets after the Expiry Date in order to provide (either itself or through a third party) services similar to the Services. If the Institution requires the Project Assets, their alternative uses will not be a relevant consideration.

17.4 If there is a substantial risk of technical obsolescence resulting from rapid technological changes or changes in the functional requirements of the Institution, with the result that the Services may become redundant before the Expiry Date, then the Institution may wish to negotiate for some flexibility for a shorter Project Term. The implications of such flexibility for the affordability of the Project and its anticipated value for money will have to be assessed on a project-by-project basis.

17.5 A number of events, particularly Relief Events, will have a significant impact on the Service Commencement Date as well as the timing of the Service Commencement Date. See Part J:46 (*Relief Events, Compensation Events and Force Majeure: Relief Events*). Relief Events should not lead to an extension of the Project Term.

Standard Clause

Duration of PPP Agreement

(a) This PPP Agreement and the rights and obligations of the Parties under this PPP Agreement shall take effect on the Signature Date.[164]

(b) The Service Period shall commence on the Service Commencement Date and terminate on the earlier of the Expiry Date and the Termination Date.

18 DESIGN RISK AND SERVICE COMMENCEMENT

18.1 Introduction

18.1.1 It is assumed in this Standardisation that the PPP Agreement will provide for a construction or development phase from the Signature Date to the Service Commencement Date, during which period the Private Party will carry out its construction or development obligations included in the Project Deliverables.

[164] See Part A:3 (*Preliminary: Conditions*). If the PPP Agreement is conditional, then this standard Clause (a) will need to be amended as appropriate.

18.1.2 The Institution should satisfy itself during its evaluation of the Private Party's bid and the negotiations on the PPP Agreement (and in any event prior to the Signature Date), that the Private Party's design proposals included in its bid will achieve the required output specifications as set forth in the RFP. Design proposals submitted at the bid stage are typically conceptual in nature and are more often than not substantially modified prior to the Signature Date. The Institution should ensure that the Private Party's design proposal that is current at the Signature Date is incorporated into the PPP Agreement. This is usually the preliminary design as the detailed design is almost always finalised after the Signature Date and should be subject to review by the Institution. Accordingly, the PPP Agreement should be sufficiently flexible to allow for changes and improvements to the preliminary design in order to allow for any planning, environmental or other requirements. The Private Party must be solely responsible for the design and, while the Institution should have a right to review the design, the Institution should have no rights of approval in respect of the design. Accordingly, all changes in the design in order to ensure that the output specifications are met or that all Consents are obtained or adhered to, should be at the risk of the Private Party. The Institution will want the reassurance that the construction or development will be capable of delivering the Services on time and in a way that meets the Institution's output specifications in the PPP Agreement. Conversely, the Private Party will not want to be "micro-managed", although it may want some reassurance that what it is constructing or developing will meet the required output specifications. This reassurance and objectivity is provided to both the Institution and the Private Party by the Independent Certifier who will inspect the completed Works and if satisfied will issue the Completion Certificate. While the Institution must be entitled to monitor the Works during the construction or development phase, it should not have any approval rights in respect of the Works. The ultimate risk and responsibility for the Works is with the Private Party who, once the Independent Certifier has issued the Completion Certificate, will issue the Availability Certificate certifying Service Commencement.

18.1.3 The prescribed approach of the National Treasury in relation to design risks (that is, the possibility that the design of the Facilities to be constructed or developed may not achieve the required output specifications) is that such risks should be borne by the Private Party. Accordingly, the key issue is the extent to which the Institution should be involved during the construction or development phase and what rights, if any, it should have to monitor and review the Private Party's progress.

18.1.4 After the Signature Date, but prior to the Service Commencement Date, the role of the Institution should include:

18.1.4.1 reviewing and commenting on (but not approving) any changes and further developments in the Private Party's design. The costs of changes to the design should be borne by the Private Party. As the Institution should have no right to veto any changes to the design, the PPP Agreement should clearly stipulate that any review and comment by the Institution will not excuse the Private Party from any liability in respect of the design;

18.1.4.2 reviewing and observing tests of any equipment being developed;

18.1.4.3 reviewing the Private Party's activities in accordance with the quality management system of the Private Party, which must be pre-agreed and incorporated into the PPP Agreement.

18.1.5 The Institution's role, therefore, is confined to the Institution reassuring itself that the delivery programme is on track and that any overriding safety issues will be satisfactorily addressed. The PPP Agreement provisions dealing with the Institution's access to information and to the Project Site during the construction or development phase should be drafted to provide for the limited scope required by the Institution, unless the Institution requires greater access to fulfil a statutory duty or comply with a statutory function.

19 INDEPENDENT CERTIFIER

19.1 Introduction

The Independent Certifier is an expert[165] who will be responsible for certifying that, in its professional opinion, the Works have been satisfactorily completed in terms of the PPP Agreement, by issuing the Completion Certificate. Once the Completion Certificate has been issued the Private Party may immediately thereafter issue the Availability Certificate signalling Service Commencement. The PPP Agreement must, however, clearly stipulate any necessary liaison procedures between the Institution and the Private Party in order to ensure that the Institution is aware of the imminent Service Commencement and is in a position to accept Service Commencement on the Service Commencement Date.

19.2 Appointment

The Independent Certifier should be appointed by the Private Party, subject to the prior approval of the Institution. The Independent Certifier should have a duty of care to both the Private Party and the Institution. The Private Party should, however, be responsible for payment of the Independent Certifier's fees. The PPP Agreement should clearly stipulate that the fact that the Independent Certifier is paid by the Private Party does not in any way derogate from its fiduciary duty to the Institution.

19.3 Duties

19.3.1 The primary function of the Independent Certifier is to inspect and monitor the Works, attend any performance testing during commissioning, advise the Private Party of any items that in the Independent Certifier's opinion require rectification and, finally, when satisfied, to issue the Completion Certificate.

19.3.2 It is essential that the terms of reference for the appointment of the Independent Certifier be agreed between the Parties and the Independent Certifier. It is

[165] Depending on the nature of the Project, the area of expertise of the expert will vary. In construction contracts this will be a person with construction experience.

advisable for this to be included in a separate agreement which should clearly stipulate the role of the Independent Certifier.[166]

19.4 **Risk**

The Independent Certifier is appointed to provide a reasonable and objective measure of ensuring that the Private Party completes the Works in accordance with the PPP Agreement. In performing its functions, the Independent Certifier does not in any way acquire any risk in relation to the design, construction, fitting, installation or commissioning of the Works. The PPP Agreement must clearly stipulate that the risk remains with the Private Party.

20 ACCEPTANCE AND SERVICE COMMENCEMENT

20.1 **New Services**

20.1.1 Before Service Commencement, the Private Party should be obliged to demonstrate that the Facilities will meet the required output specifications. The method of demonstration to be used by the Private Party will be project-specific but may take the form of inspections, demonstrations, acceptance or commissioning trials or other performance tests.

20.1.2 The PPP Agreement should set out in detail:

20.1.2.1 the provision by the Private Party to the Independent Certifier and the Institution of adequate prior notice of any performance test;

20.1.2.2 the rights of the Institution and the Independent Certifier to access the Project Site to witness the performance tests where the Institution does not otherwise have access to the Project Site;

20.1.2.3 the documents required to evidence the results of the performance tests;

20.1.2.4 that the Independent Certifier shall be responsible for assessing the success or failure of the performance tests;

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[166] This contract must be included in the Project Documents for the Project.

20.1.2.5 the procedure for the Private Party to remedy any defects that result in a failure to pass any such performance test as notified by the Independent Certifier;

20.1.2.6 the consequences for the Private Party of a failure to remedy any such defects. This will usually result in the Independent Certifier not issuing the Completion Certificate, the Private Party therefore not being able to issue the Availability Certificate and the Unitary Payment not becoming due; and

20.1.2.7 if the results of the performance tests are satisfactory to the Independent Certifier, the timing and procedure for issuance of a Completion Certificate by the Independent Certifier indicating acceptance that the Works have been completed in accordance with the terms of the PPP Agreement.

20.1.3 Only once the Independent Certifier has issued the Completion Certificate should the Private Party be entitled to issue the Availability Certificate declaring the Service Commencement Date. The Completion Certificate is a pre-requisite for the issuing of the Availability Certificate. Once the Completion Certificate has been issued and the Institution is ready to accept Service Commencement pursuant to the terms of the PPP Agreement[167], the Private Party may issue the Availability Certificate. Once the Availability Certificate has been issued by the Private Party, the Services are deemed to be available and the Unitary Payment is payable from that date, being the Service Commencement Date.

20.1.4 The Institution should generally not seek to impose pre-Service Commencement milestones in the construction or development phase or otherwise accept the delivery of the Works in stages prior to Service Commencement as this may reverse the prescribed allocation of risk.[168] Ideally the Independent Certifier should not be entitled to accept incomplete

[167] See Section 21.6.2.

[168] In projects that are partly funded by means of a capital contribution by the Institution or other government entity, it may be necessary to provide for the achievement of construction milestones when capital contribution payments will be made to the Private Party.

construction for the purposes of issuing the Completion Certificate. This may affect the risk transfer as the Private Party may seek a waiver of Penalty Deductions, certain indemnities against loss due to injuries that may be suffered as a result of the use of an incomplete Facility, as well as payment of the Unitary Payment. In certain PPPs, however, it may be appropriate to have Service Commencement, despite incomplete construction.[169] Here the Institution must, however, ensure that the Private Party always remains "incentivised" (through the payment mechanism)[170] to complete the outstanding Works.[171]

20.1.5 In certain PPPs it may be feasible to have phased-in Service Commencement[172] (that is, different buildings or sections or different pieces of plant and equipment being brought into service at different milestones in the PPP) in which event an appropriate phasing-in of the Unitary Payments may be justified. In such cases, the Institution may either:

20.1.5.1 stipulate that full Service Commencement will only be achieved when all phases in the Project reach the required output specification level, which would incentivise the Private Party to bring them all up to the required output specification levels as quickly as possible; or

20.1.5.2 stipulate that partial Service Commencement will be achieved as each phase reaches the output specification level for the Services being provided, so that Unitary Payments reflect the Services actually available.

The choice of which alternative to apply will depend on the overall time period between the final Scheduled Service Commencement Date and full Service Commencement. The longer the period, the more reluctant the Private Party is

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[169] For example, in an accommodation project the Institution may accept Service Commencement where certain aspects of the Works (such as, landscaping) are not completed, as long as these are not integral to the Private Party's ability to provide the main Services.

[170] See Part F:23 (*Services*).

[171] The Institution should seek specific advice from its technical advisors regarding those Services that can be postponed.

[172] Such as road projects.

likely to be to accept the delayed payment involved in the first alternative above.

20.2 **Existing Services**

20.2.1 The acceptance procedure raises other issues if the Private Party takes over existing infrastructure and Services.[173]

20.2.2 The first issue is when and to what extent the Private Party takes responsibility for availability of existing services. There are three options available to the Institution:

20.2.2.1 the responsibility for all sites (including existing sites and new sites) is assumed by the Private Party from the Signature Date. This is the simplest option as it minimises complexities regarding the respective responsibilities of the Institution and the Private Party and is, therefore, the recommended approach. However, where there are concerns about the condition of existing buildings constructed and maintained by third parties, this approach may expose the Private Party to risks that it cannot manage and it may therefore only be willing to accept those risks at a greater cost to the Institution, which may compromise value for money;

20.2.2.2 a phased handover of the existing site so that the Private Party takes responsibility for these sites only when it is given vacant possession of such sites to commence its required Works. This leaves the Institution responsible for certain sites between the Signature Date and the date on which the Works are scheduled to commence on site. Also, the issue of who is responsible for the costs of bringing the sites up to full output specification level has to be agreed. Unless clearly stipulated in the RFP, it is unlikely that the Private Party will easily accept the risk of these costs, especially without having first undertaken an extensive due diligence (see Part D: (*Project Site*)); or

[173] For example, the take-over of existing accommodation and related facilities management services.

20.2.2.3 access (falling short of handover) to the existing site for the purpose of carrying out the Works followed by a handover of all existing sites to a Private Party only once they have been brought up to the full output specification standard by the Private Party. This would cause additional complexities as the pre-Signature Date arrangements, involving in-house provision of services or a separate contractor, would continue simultaneously while the Private Party is carrying out the Works to bring the site up to the full output specification standard. This option is not preferred, as it creates potential for disputes over responsibilities. This can be mitigated by specifying in minute detail the interface between these respective roles.[174]

20.2.3 In some cases, the existing condition of buildings may be such that there is a risk of pre-existing non-compliance with health and safety legislation. The PPP Agreement will require the Private Party to conduct the Project Deliverables in accordance with applicable law, thereby exposing the Private Party to legal risk for pre-existing conditions. Even if the funders of the Private Party permit the Private Party to assume all risk for pre-existing conditions (which is improbable), they will be reluctant to permit the Private Party to assume this risk during the period before the Service Commencement if the Private Party does not have exclusive possession of the site. In such circumstances, the Institution may consider entering into an ordinary service provision arrangement until the commencement of the Service Period, since in a traditional "input"-based contract there is no substantial risk transfer. This means that the Institution still retains responsibility for the buildings until Service Commencement.

20.2.4 In PPPs, ordinarily,[175] no Unitary Payments should be made until the Services are fully available.[176] In relation to the takeover of existing Services, this

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[174] Certain projects have provided for "enabling works" to be undertaken prior to the Signature Date in an attempt to fast-track the Works once they actually begin. These works can be undertaken by the preferred bidder or a third party. While Institutions have tended to favour "enabling works" as they can fast-track a project, "enabling works" have similar risks to those detailed in Section 20.2.2.3 and are therefore not advisable. To the extent that this is unavoidable given the specific project, it is preferable that these "enabling works" be undertaken by the preferred bidder as opposed to a third party.

In other projects, the Services adjoin services provided by a third party or the Institution. Again it is imperative that the interface be clearly detailed so as to minimise any disputes.

[175] This is not the case in revenue-generating projects, for example, toll roads.

principle will not be strictly applied. Here, the Institution can take one of two approaches in relation to Unitary Payments during the transitional period (that is, the period between initial delivery and full Service Commencement). The selection of either approach will depend upon which provides the best value for money:

20.2.4.1 the Institution bases the Unitary Payments to be made before Service Commencement on its current expenditure (pre-Signature Date) subject to a performance regime, which entails that Availability Deductions will be made if the building is unavailable and Penalty Deductions in the event of poor performance. Payment for those parts of the Services that are available will not diminish the significance of full Service Commencement as the Private Party will be incentivised by the performance regime to achieve full Service Commencement; or

20.2.4.2 the Institution makes no Unitary Payment during the transitional period. This maximises the incentive on the Private Party to bring the Facilities up to the full Service Commencement level as quickly as possible, but may not satisfy the cash flow needs of the Private Party.

21 SECURITY AGAINST LATE SERVICE COMMENCEMENT

21.1 Introduction

21.1.1 The Institution may want to ensure that it is protected against late Service Commencement but should do so in a way that provides value for money (taking into account the actual losses the Institution may suffer for late Service Commencement and the necessity and cost of implementing contingency plans).

21.1.2 In considering the issue of late Service Commencement, the Institution should acknowledge that the Private Party is likely to be as concerned as the Institution to meet the Scheduled Service Commencement Date, given the cost of alternative funding if the Unitary Payments do not commence and the risk of default under its Financing Agreements as the Unitary Payments will not be

[176] See Part F (*Services*).

available to meet scheduled debt service. A delay in Service Commencement will reduce the Private Party's revenue-earning period. The Private Party is likely to put measures in place to mitigate the effects of late Service Commencement such as insurance or standby debt and/or standby equity facilities. The Lenders, however, usually require standby debt and/or standby equity facilities as part of their security package and, while this provides comfort to the Institution, the Institution should not require it. The adequacy of these mitigation measures should be considered by the Institution in its due diligence (see Part B:4 (*Project Documents and Project Deliverables: Project Documents*)).

21.1.3 If the Institution will not suffer significant losses resulting from late Service Commencement, then the protections allowed by security will not be needed. The issue of security against late Service Commencement must be considered on a project-by-project basis, regard being had to the particular phases of the relevant project, the specific risks in each such phase, the Institution's exposure during each such phase and any existing protections already in place that would mitigate these risks, such as guarantees from the Subcontractors to the Private Party, non-payment of the Unitary Payment until the Services commence and any restrictions on the transfer of the Equity for a defined period.[177] The Institution must analyse these during its feasibility study, bearing in mind the specific risk/s that it seeks to mitigate, the type of security available as well as the value for money and affordability considerations. It is possible to obtain extensive security as protection against late Service Commencement but the Private Party will price the costs of providing such security into its bid. Where it is essential to obtain some form of security given the particular project or particular phase of a project, this may be justified. The different types of security available to the Institution in order to ensure timeous Service Commencement include construction bonds and liquidated damages. At the feasibility stage of each project, the Institution must assess its security requirements in relation to that project. In the RFP the Institution should clearly stipulate the type as well as the amount of any security that it will require from

[177] This has been common in many deals with Equity lock-in periods varying from three to five years.

the Private Party and request that each bidder cost for such security separately from its total bid price as this will aid in the evaluation process. See Part F:32.5 (*Services: Maintenance in General*) for security regarding the condition of the Project Assets during the Service Period and Part N:62 (*Termination: Handback*) for security regarding the condition of the Project Assets immediately prior to the Expiry Date.

21.1.4 The Institution may also want to protect itself against prolonged uncertainties arising from late Service Commencement by having a Long Stop Date after which it may terminate the PPP Agreement.

21.1.5 Once the Parties have agreed on the type of security to be provided, the PPP Agreement must clearly stipulate how the proceeds of such security will be applied. Given that it will usually be called upon in cases where the Private Party has defaulted, the proceeds should first be applied towards rectification of the defect. Thereafter, depending on what has been agreed with the Lenders, the remaining proceeds could be applied towards debt service. The exact nature of this waterfall will depend on the specific needs of the particular project.

21.2 **Liquidated Damages**

21.2.1 Liquidated damages for late Service Commencement are an ascertained payment representing a genuine pre-estimate of the actual losses or damages the Institution will suffer if the Private Party fails to achieve Service Commencement on time.

21.2.2 If the Institution will not suffer any losses or damages in excess of the amount of the Unitary Payment, taking into account the cost of the Institution procuring the Services from alternative sources, liquidated damages will not be appropriate.[178] If the Institution will suffer such losses, then liquidated damages will only be appropriate to the extent that they will result in value for money for the Institution taking into account all other protections which the Institution will have against late Service Commencement.

[178] See also Part C:9.5 (*General Obligations: Claims for Damages*).

21.2.3 To protect against late Service Commencement and non-payment of the Unitary Payment, the Lenders will usually require the Construction Subcontractor to cover the debt service for the period of the delay through liquidated damages payable to the Private Party and secured in favour of the Lenders. The Construction Subcontractor would, in turn, price the cost of such liquidated damages by increasing the Works price and by extending the Works period to include some contingency time. To the extent that the Institution also imposes liquidated damages on the Private Party these will also be passed on to the Construction Subcontractor which will result in an increase in the Works price. The Private Party will then be more than likely to pass these increases in costs on to the Institution through an inflated Unitary Payment and/or by extensions to the Works period.

21.2.4 Liquidated damages may provide value for money in situations where the costs which the Institution will incur as a result of the delay, are so great as to justify the increased Unitary Payments. This could be the case where there are "critical dates" for achieving Service Commencement and the costs of the Institution's contingency plans to cope with such critical dates are measurable.[179] Liquidated damages may also be justified where the Institution has contributed a valuable Institution Asset to the Project which could otherwise have been used by the Institution during the period prior to the Service Commencement for some other purpose, resulting in the Institution incurring an "opportunity cost".

21.2.5 If the imposition of liquidated damages will not impact severely on the value for money required for a PPP, the Institution should specify the level of liquidated damages (including any cap) in the RFP in order to enable the bidders to properly price for these damages. This will also assist the Institution's evaluation team in exposing the "real" costs of the bid and improve competitiveness in the selection of the bids.

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[179] For example, in accommodation projects where the Institution may have to lease temporary premises to make up for the accommodation that is not available in time.

21.2.6 The Institution should ensure that the level of the liquidated damages reflects a genuine and reasonable pre-estimate of the losses which the Institution is likely to incur as a result of the delay in the Service Commencement. The amount of the liquidated damages should not be unrealistic, punitive or excessive as this will expose the Institution to the legal risk of non-enforcement of liquidated damages.[180]

21.3 **Construction Bonds**

21.3.1 In the construction industry, construction bonds are generally given by construction contractors as a form of guarantee of completion (the amount guaranteed is usually a percentage[181] of the construction price). A construction bond will usually take the form of an on-demand bank guarantee which can be called by the recipient when, for example, the Scheduled Service Commencement Date is not met. Accordingly, the Private Party may well require a construction bond from the Construction Subcontractor who will pass through the costs and time effects of providing such a bond to the Private Party, who will in turn pass them on to the Institution in the form of an increased Unitary Payment and/or Works period. Again, this may not result in the projected value for money, depending on the nature of the Project. The PPP Agreement should clearly stipulate how the funds will be applied, for example, first towards reinstatement and after that towards debt service.

21.3.2 If the Private Party defaults during the construction period and the PPP Agreement is terminated, then in many cases the Institution will be left with an asset. The Project Site, the planning Consents that will have been obtained prior to the Signature Date, and any construction work undertaken up to termination will all have some value to the Institution. The Institution may, however, be exposed if the Private Party defaults during the early stages of the

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180 This legal risk arises from the provisions of the Conventional Penalties Act, 1962 which does not permit the enforcement of liquidated damages to the extent that the liquidated damages are disproportionate to the prejudice suffered by the creditor (in this case, the Institution) by reason of the breach for which the liquidated damages are being stipulated. The courts are empowered pursuant to section 3 of this Act to reduce the liquidated damages to an extent that they consider equitable in the circumstances.

Unless the PPP Agreement expressly permits the Institution (as creditor) to recover its actual damages in lieu of the agreed liquidated damages, an Institution will only be entitled to recover the agreed liquidated damages and not its actual damages. Since bidders faced with the possibility of such a choice on the part of an Institution will be encouraged to inflate their bid prices, the Institution should consider the implications of such a choice on value for money.

181 Ten percent is typical in South Africa.

construction period and the Institution cannot find another party to take over the Project and thus has to incur significant cost in reinstating the Project Site. This scenario is often unlikely in that the Private Party is more likely to invest further money into the Project in order to remedy a problem than it is to walk away and lose its Equity (together with the design and build costs invested up to date). Conceivably the situation could arise where the Private Party decides to abandon the Project if it is in default and faced with substantial rectification costs and if the Lenders decide not to enforce their security. The Institution will need to consider the probability of this risk occurring on a project-by-project basis.

21.3.3 The need for such bonds is greater when failure by the Private Party to complete the Works will result in substantial costs to the Institution. It is unlikely that the amount of such bonds will be sufficient to enable the Institution to complete the Works but it will, at the very least, provide the Institution with sufficient financial resources to procure a replacement contractor to complete the Works. Even if the Institution decides not to proceed with the Works, it may still incur costs in relation to restoring the Project Site to the condition it was in prior to the commencement of the construction. There is, on the other hand, very little need for a bond where the Private Party is handed an existing facility with minimal obligations during the pre-Service Commencement phase.

21.3.4 The Institution should carefully consider the need for construction bonds on a project-by-project basis, regard being had to affordability and value for money considerations. In the event that the Institution requires any such bond the objective should be (having regard to affordability and value for money considerations) to ensure that the bond only covers the period when the Institution is exposed and should automatically fall away when a predetermined and agreed trigger point is reached. This could occur when the Works have reached a certain pre-determined value or when the Completion Certificate is issued. The trigger point will, however, depend on the particular project and has to be determined on a project-by-project basis.

21.4 **Sponsor Support**

Sponsor support usually takes the form of undertakings from one or more of the sponsors of the Private Party in favour of the Lenders and/or the Private Party to support the Private Party's obligations to reach Service Commencement on time. This need not be a monetary guarantee and usually takes the form of technical support and/or general undertakings to ensure that the Private Party reaches Service Commencement. Although sponsor support is in favour of the Private Party and/or the Lenders, its existence does provide comfort to the Institution and the Institution should therefore consider the adequacy thereof in its due diligence.

21.5 **Long Stop Date**

21.5.1 Service Commencement should not be allowed to be delayed indefinitely due to Private Party Default. This is because in terms of the PFMA an Institution remains responsible and accountable for the provision of the institutional function that is the subject of a PPP Agreement.

21.5.2 To deal with this, the Institution may impose a Long Stop Date after which the Institution may be entitled to terminate the PPP Agreement.

21.5.3 The Long Stop Date is a date fixed after and by reference to the Scheduled Service Commencement Date and is usually determined on the basis of the length of time the Private Party and/or its Lenders should reasonably be allowed to remedy the Private Party Default. In order to prevent hair-trigger defaults, the Long Stop Date is usually some time after the Scheduled Service Commencement Date (including the remedy period).

21.5.4 The Long Stop Date operates as a disincentive for delay. An alternative approach involves incentives for timeous or early commencement. This alternative approach relies on economic incentives for the Private Party to achieve early Service Commencement.

21.6 **Incentives for Early Service Commencement**

21.6.1 It may be proposed that "incentive payments" should be paid for early Service Commencement. The term "incentive payment" is, however, misleading since it does not necessarily involve an additional payment over and above the Unitary Payment but merely entails receipt of the Unitary Payment earlier than anticipated.

21.6.2 The key issue is that the Institution should not be obliged to accept early Service Commencement unless there is value for money. This must be assessed on a project-by-project basis. Early Service Commencement may provide value for money if there is an urgent demand for the Services or if it would benefit the Institution financially. This might be the case if the early Service Commencement meant that the Project generates additional revenues from end-users other than the Institution or if the Private Party makes savings in which the Institution shares.

21.6.3 However, in a situation where the payment mechanism in a PPP Agreement involves Unitary Payments payable by the Institution and is not based on charges from other end-users, there may be budgetary constraints on the Institution accepting and paying for early Service Commencement.

21.6.4 If an Institution decides to accept early Service Commencement, the Private Party's revenue stream will commence earlier than originally planned. This however should not affect the Expiry Date, which should remain fixed.

22 QUALITY ASSESSMENT

22.1 The Private Party should be under an obligation to implement a quality assessment and management system which meets the requirements of Good Industry Practice and any other applicable standards. This will depend on the nature of the Project.

22.2 The Institution should be entitled to review the Private Party's quality assessment and management system and, further, to rights of inspection to establish the adequacy and accuracy of that system. The PPP Agreement should provide for this and also for the Private Party to provide, and to cause the Subcontractors to provide, all reasonable assistance to the Institution in relation to that review and to respond to and implement results arising from such review.

22.3 No other rights or remedies (such as the right to terminate) should arise from any such review, as deficiencies in the quality assessment and management system will probably manifest themselves through poor performance in the delivery of the Services for which the payment mechanism should provide appropriate Penalty Deductions.[182]

[182] See Part F:23 (*Services*).

PART F: SERVICES

23 SERVICES

23.1 The substance of a PPP is normally the procurement of Services.[183] The Institution should carefully consider its needs in relation to the Services and the PPP Agreement should clearly detail the output specifications required to be met by the Private Party. The PPP Agreement must provide that the Services are to be available in accordance with the output specifications in the PPP Agreement and that Penalty Deductions from the Unitary Payment may be made for unavailability of the Services or for poor performance.

23.2 Delivery of the Services in a manner that exceeds the output specifications should not be rewarded by means of service credits. While service credits may have a certain appeal, they could result in the output specifications being set too low so as to result in regular service credits being awarded. In setting the output specifications, the Institution should seek to achieve an acceptable level of Services that are affordable and provide value for money. Also, as service credits often take the form of set-off against Penalty Deductions, the Private Party's responsibility[184] for poor performance in a critical area[185] could be reduced because it has performed exceptionally well in another area of the Project that is of little consequence.[186]

23.3 The requirements of each Project will determine the exact nature of the Services required. The availability of the Services is important because the Institution is required to pay for the Services if they are available in terms of the PPP Agreement, even if they are not used (see Part H: (*Payment and Financial Matters*)).

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[183] The definition of "Services" is crucial. It must therefore be carefully defined in as much detail as possible. A separate annexure will be necessary.

[184] Penalty Deductions should however be weighted depending on the importance of the relevant aspect of the Services and the criticality of the loss of performance. Therefore, while service credits may result in reduced responsibility there should still be a monetary loss to the Private Party.

[185] For example, security in a prison project.

[186] For example, watering the plants in a prison project.

23.4 In procuring the Services, Institutions must assess both their current and future requirements. The demand or usage of the Services is a key risk assessment, which has to be determined throughout the Project Term. In drawing up the output specifications for the Services, Institutions should carefully consider their current as well as future requirements in order to minimise the need to change the output specifications. To the extent that this is unavoidable, such changes must be dealt with in terms of the Variations provisions, bearing in mind the impact on affordability.[187] However, Institutions should, if at all possible, ensure that adequate planning is done to ensure that the long-term demand for the Services can be met and all associated risks appropriately managed and mitigated.

24 DEFINITION OF "AVAILABILITY"

24.1 The concept of "availability" (or, at least, its converse) must be defined.[188] The definition should detail the specific conditions that must be met if the Services are to be considered available. The concept of availability usually relates to more critical failures and does not deal with less important performance related matters. The definition of availability must contain conditions which are objective, measurable and reasonable, and should not contain conditions which are unachievable or immaterial in the context of the Services as a whole, since the Unitary Payment is due when these conditions are satisfied.

24.2 Each PPP Agreement will require different conditions to be inserted into the definition which should, therefore, be as comprehensive as possible. Unavailability occurs if the relevant key objective conditions determining availability are not satisfied. Each Project will determine unavailability but, generally, unavailability will occur as a result of the non-availability of the Services.

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[187] See Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

[188] It may well be appropriate to detail the concept of availability in a Schedule to the PPP Agreement.

24.3 The PPP Agreement should provide for unavailability to be measured following a simple process. Consequently, complex processes that require excessive monitoring costs should be avoided.

24.4 The full Unitary Payment is due when the Services are available. Penalty Deductions from the Unitary Payment are allowed in two instances. First, Availability Deductions when there is unavailability of the specified critical aspects of the Services and secondly, Performance Deductions for the less severe performance related failures.

24.5 The concept of "Scheduled Unavailability" relates to unavailability that is planned and agreed between the Parties. This is usually for reasons such as scheduled maintenance and should not result in deductions from the Unitary Payment.

25 PAYMENT FOR AVAILABILITY

Payment for availability of the Services varies from project to project. Different types of projects require different payment mechanisms and allocation of payment depending on the availability of the agreed Services. (See Part H: (*Payment and Financial Matters*)).

26 COMMENCEMENT OF AVAILABILITY

The PPP Agreement must specify the date/s for the provision of the Services and the consequences, if any, where the Services are available either before or after the Scheduled Service Commencement Date. The Institution may not be obliged to make any Unitary Payment before the Scheduled Service Commencement Date unless specifically agreed to in the PPP Agreement. To provide for the management of the delivery of the Services, the PPP Agreement should provide for adequate notice to be given to the Institution and the Independent Certifier in circumstances where the Private Party anticipates that there will be early availability of the Services, and also where the Private Party knows that there will be a delay.[189] The

[189] This is in addition to any notices required in respect of acceptance and Service Commencement. See Part E: (*Duration and Service Commencement*).

Private Party should not be entitled to issue an Availability Certificate until the Independent Certifier has issued the Completion Certificate.

27 COMMENCEMENT OF UNAVAILABILITY

Unavailability of the Services will commence when an unavailability failure occurs. When the failure has been rectified and, if necessary, certified (by, for example, a safety officer), the Services will automatically revert to being available again.

28 RECTIFICATION

28.1 Unless adequate tolerances are already incorporated in the required availability and performance levels set for the Services, the PPP Agreement should provide for a rectification period within which the Private Party is given the opportunity to rectify the problem without triggering the start of a period of unavailability or the accrual of Penalty Deductions. The period allowed for rectification will depend on the nature of the Project, the nature of the problem, Good Industry Practice, as well as the importance of the availability or performance of the specific Services to the Institution. Important factors in assessing rectification are responsiveness, rapid assessment, situation management and rectification in accordance with the availability and performance specifications in the output specifications. A failure to meet certain availability criteria may not be capable of rectification, in which case the provisions dealing with termination (see Part N: (*Termination*)) will apply. If the nature of the Project permits, the Private Party should be allowed to provide adequate alternatives, so as to ensure continuity of the Services.

28.2 If the problem is corrected in the rectification period, then no Penalty Deductions should be made. If the problem is not corrected in the rectification period, then the Services should be deemed to have been unavailable even in the rectification period and Penalty Deductions should be made.

29 SERVICE UNAVAILABLE BUT USED

29.1 The PPP Agreement must specify what happens if the Institution continues to use the Services despite the existence of defects, which would otherwise render parts of the Services unavailable. Each Project needs to be considered according to its own Services requirements, but the fundamental principle to be applied is that the Private Party should not receive full payment where it does not provide the Services to the required availability standard.

29.2 Availability is a critical factor in all PPPs. Therefore the dispute resolution procedure should contain a mechanism to ensure a quick resolution of any disagreement in this regard. This is usually by means of an Independent Expert. (See Part S:86.2 (*Miscellaneous: Fast-track Dispute Resolution*)).

30 RESTORATION OF AVAILABILITY

When the failure that resulted in the poor performance or unavailability has been rectified, the Services will once again become available. There should be an agreed procedure by which the Private Party notifies the Institution that the Services are once again "available" or that the poor performance has been rectified. While the Institution may want the right to inspect the operations or review documents, it should not be drawn into intricate procedures to confirm availability. Like initial "availability", the Private Party must certify this and, if any part of the Services are not available, the Availability Deductions should be triggered. Likewise, if the performance has not been rectified, the Performance Deductions should be triggered. While the Institution has certain statutory functions relating to the monitoring of the Services, their availability and performance are the responsibility of the Private Party. The Private Party must ensure that mechanisms have been set up which will enable it to self-monitor availability as well as performance.

31 PLANNED MAINTENANCE

31.1 Ongoing maintenance is required to ensure that the Private Party keeps the Facilities in a condition that meets the required output specifications throughout the Project Term. (See Section 32 (*Maintenance in General*)). As maintenance is the responsibility of the Private Party, the Private Party should determine the nature, frequency and duration of any maintenance that it requires in order to meet the output specifications as well as fulfil its obligations under the PPP Agreement. The Private Party should prepare a programme for the planned maintenance and provide the Institution with a copy of such programme for its information. The Private Party should be under the obligation to ensure that any and all maintenance that it undertakes does not interfere with the operations of the Institution. To the extent that such interference is unavoidable, the Parties should agree on the programme for such maintenance so as to minimise any such interference. The Private Party should be entitled to amend its maintenance programme. This should, however, not derogate from its obligations to supply the Services under the PPP Agreement.

31.2 There should be no Availability Deductions during periods when preventive maintenance takes place as planned in the PPP Agreement. The Private Party will have to balance whether maintenance occurring at times other than those agreed will result in the improvement or worsening of its financial position (for example, by postponing or accelerating maintenance).

32 MAINTENANCE IN GENERAL

32.1 Introduction

32.1.1 The Private Party should base its costings on a forecast capital replacement programme of plant, machinery, equipment, fixtures, fittings and/or furniture designed to maintain the Facilities in order to meet the required output specifications. The Private Party will also consider the means of funding this expenditure throughout the Project Term. The risk associated with assessing what will need replacing, when and how much this will cost, is one that the Private Party should take and therefore the Institution should not attempt to be prescriptive in this respect.

32.1.2 The Institution will find it easier to achieve this risk transfer if its required output specifications are clearly expressed. The bidders should be allowed to develop their own proposals, which may, for example, incorporate alternative programmes of maintenance where assets with a longer life are used or used differently. An Institution should refrain from imposing its own system of asset replacement on the bidders because this may adversely affect risk transfer.

32.1.3 A planned preventive maintenance programme is recommended so that both Parties know when parts of the Services are permitted to be "unavailable" without any Availability Deductions. In addition, provision should be made for how emergency maintenance, if any, will be handled so as to ensure minimum interruption of the Services.

32.2 Expiry of the PPP Agreement

As the Expiry Date approaches, the Institution's interest in the maintenance of any Project Asset will become most acute where such Project Asset is to be transferred to the Institution on expiry. At the Signature Date, the Parties must agree on the requirements relating to handover of such Project Assets at the Expiry Date. (See Section 32.4 (*Monitoring*) and Part N:62 (*Termination: Handback*)).

32.3 Alternative Use

How, when and to what extent maintenance should be undertaken is the responsibility of the Private Party. If the PPP Agreement requires that any Project Assets be handed over to the Institution on termination or expiry, then the Institution should consider obtaining some security from the Private Party in order to ensure that the Project Assets comply with the requisite standards at handover. (See Section 32.5 (*Security for Maintenance Obligations*) and Part N:62 (*Termination: Handback*)).

32.4 Monitoring

Particularly where the Institution will take over Project Assets at the end of the Project Term, the performance by the Private Party of its maintenance obligations as stipulated in the PPP Agreement will need to be monitored throughout the Project Term (other than through the performance monitoring system, see Section 33.3 (*Monitoring Methodology*) and thus a mechanism needs to be agreed whereby this can be done in as non-intrusive a manner as possible. This is, however, merely a monitoring function on the part of the Institution. Although the Private Party should be informed of any non-compliance with its maintenance obligations as stipulated in the PPP Agreement found by the Institution, the Private Party should not be obliged to follow any particular course of action as a result of such findings. Only if the monitoring indicates unavailability or poor performance, should Penalty Deductions be made. The Private Party's failure (following notification from the Institution) to fully perform its maintenance obligations will ultimately be reflected in reduced compensation on termination.

32.5 **Security for Maintenance Obligations**[190]

32.5.1 The Unitary Payments payable by the Institution include amounts to cover the Private Party's anticipated future expenditure on maintenance. The Private Party will therefore usually build up a maintenance reserve over some years in anticipation of significant capital expenditure in future periods including in the final years of the Project Term, if the Institution is to take over any Project Assets at the expiry of the PPP Agreement.[191]

32.5.2 The Institution should generally not require security in respect of the Private Party's maintenance obligations during the Service Period as poor performance can and should be penalised by the accrual of Performance Deductions. An exception is permitted for bonds that are used to secure the Private Party's *final* maintenance obligations in relation to the Project Assets where these are to be transferred to the Institution on termination or expiry.

32.5.3 The need for such security in the PPP Agreement has to be measured on a project-by-project basis. Maintenance should, however, generally be at

[190] See also, Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) for a discussion of alternative forms of security.

[191] Throughout the debt service period, the Lenders will be concerned with the level of the Private Party's maintenance reserve(s) given that the non-performance by the Private Party of its maintenance obligations will be reflected in the amount of the compensation payable to the Private Party on termination (that is, the compensation will be reduced to reflect the condition of the poorly maintained Project Assets at that time).

Once the Debt has been repaid (which will ordinarily occur well before the end of the Project Term), the Lenders will have no interest in the condition of the Project Assets on handover to the Institution.

the Private Party's risk and, therefore, the Institution should not attempt to prescribe the *quantum* or availability of any maintenance reserve account or other provisions (for example, a sinking fund) kept by the Private Party to meet its maintenance obligations. However, details of the balance of such account should be provided to the Institution on an annual basis.

32.5.4 The Institution should generally not require rights over any maintenance reserve account established by the Private Party and should instead ensure that the maintenance requirements are adequately protected through the payment mechanism and termination provisions.

32.5.5 As any compensation payable to the Private Party by the Institution on a termination is usually reduced by all cash held by the Private Party, including amounts in any reserve accounts, the Institution should not need any additional rights over any maintenance reserve accounts and thus the Lenders may be permitted to hold security over such reserve accounts.

32.6 Security for Final Maintenance Obligations

32.6.1 Where the Project Assets are needed for the provision of essential services after the end of the Project Term, it is advisable for the Institution to request some form of security in relation to the condition of the Project Assets on handover. In this respect, final maintenance bonds have proved to be useful.

32.6.2 Final maintenance bonds are a form of security that has been used in projects where residual value risk has not been transferred to the Private Party. These are typically on-demand bank guarantees that are often costly to procure. They are often issued during the last 18 to 24 months of the Project Term and remain valid for a few months after the Expiry Date.

32.6.3 Another option may be to require the Private Party to establish a maintenance reserve account[192] or for the Institution to withhold a predetermined amount from the Unitary Payments in the final months[193] of the Project Term and to deposit those into a maintenance reserve account. Reserve accounts and deductions from the Unitary Payment can, however, prove to be rather costly as withholding such payments creates a lost opportunity cost which is often greater than the cost of a bond.

32.6.4 A further option may be a compromise between the two approaches where the Private Party is required to provide a final maintenance bond and, only if it fails to do so, may the Institution withhold amounts from the Unitary Payment. This will, however, depend on the specific project and will need to be assessed by the Institution on a project-by-project basis, having regard to, among other considerations, value for money. The Institution must clearly assess this risk during feasibility and stipulate its requirements in the RFP. The bidders must be asked to price for this security separately.

33 PERFORMANCE MONITORING

33.1 Introduction

33.1.1 Although the Unitary Payment is due and payable on availability, performance of the Services to the required output specifications is important as Performance Deductions will accrue for poor performance.

33.1.2 The PPP Agreement should therefore clearly set out:

33.1.2.1 the level of performance entailed by the required output specification;

33.1.2.2 the means by which the Institution is able to monitor the Private Party's performance against such required level; and

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192 Private Parties may prefer this as these accounts will accrue interest.

193 This period will vary from project to project and may be anything from 12 to 36 months.

33.1.2.3 the consequences for the Private Party of a failure to meet the required level.

33.2 **Setting the Performance Level**

33.2.1 In order to encourage innovation and optimise risk transfer, the PPP Agreement should specify the required performance level through output specifications and not required inputs (that is, the manner of the Services delivery).[194] Suitable performance levels will need to be worked out carefully by the Institution and the bidders during the competitive stages of the procurement. The negotiated performance levels will form a key element of the risk transfer mechanism.

33.2.2 In setting the performance levels, the Institution should focus primarily on what it requires, taking into account affordability and value for money and not, for example, on what it is accustomed to. Affordable performance levels should be set by the Institution based on Good Industry Practice.

33.2.3 If the Institution is already providing the same type of service as all or part of the Services, this may provide a comparator against which the Institution may compare the quality and price of the Private Party's bid.

33.2.4 An alternative method is to set the performance levels by reference to the average performance levels of a comparator group made up of other providers of the same or similar services. For example, in prisons the comparator group would include a number of similar establishments and as such the levels of performance by the service providers in those establishments are ascertained and an appropriate comparator is thereby obtained.

33.2.5 This is however not recommended because if there were to be a deterioration in the quality of services elsewhere, then the Private Party

[194] In IT projects, where technology is constantly changing, the performance level may be set so as to include the concept of "continuous improvement". This will involve a review of the service levels over the Project Term. Here, the Institution should retain the right, subject to agreed controls, to set the performance levels as well as the relationship between the performance levels and the deductions.

would benefit in that it would (even if it were able to perform fully and is unaffected by the reason for a wider deterioration) be expected to perform the Services at a lower level.

33.2.6 As with availability (see Section 24 (*Definition of "Availability"*)) and performance, the funders will be concerned that the performance level required is reasonable and objectively measurable. They will seek to establish that the Unitary Payment will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that allows the Debt to be serviced and the Equity return to be paid. In considering what a reasonable level is, the Institution should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the Services) to set the required standard in the PPP Agreement at this level.

33.2.7 In some cases, the Institution may recognise that an optimum 100% standard is not always achievable or essential. As such, the Institution may retain the optimum 100% level but allow a specified leeway before the Private Party suffers Penalty Deductions for unavailability or poor performance.

33.3 Monitoring Methodology

33.3.1 There must be a methodology in the PPP Agreement that enables monitoring of the Private Party's performance against the required output specifications in the PPP Agreement so that the performance measurement system can operate effectively.

33.3.2 The monitoring requirements should be set out in the RFP and a full methodology must be included in the bid. The methodology will normally include a substantial element of self-monitoring by the Private Party, subject to periodic Institution review. Additional Institution monitoring may also take place depending on the nature of the Project, for example, clinical staff in a hospital identifying and reporting performance failures. The periodic reports[195] to be provided by the Private Party will be key to the management of the PPP Agreement and to the payment mechanisms, and should be specifically tailored to meet these monitoring requirements. A distinction must be made between the monitoring mechanism formulated and implemented by the Private Party and any actual monitoring undertaken by the Institution as and when it deems necessary in accordance with the PPP Agreement. The Private Party should have the primary responsibility for the former and the PPP Agreement should clearly provide how it will conduct this self-monitoring which will constitute the basis for the calculation of Penalty Deductions.

33.3.3 Monitoring involves the collection and evaluation of data that should be objective, relevant and quantifiable. There should be a clear connection between the data collected, unavailability, poor performance and the Penalty Deductions.

33.4 Commencement of Performance Monitoring

33.4.1 The PPP Agreement must specify the date by which the performance levels are to be achieved. In some projects, such as IT projects, it is recognised that problems are inevitable in the settling-in period, and thus the Private Party may be afforded a degree of flexibility in achieving the agreed performance levels. In other projects such as roads and prisons (where the safety element is crucial), it is essential that the Private Party ensures there are no settling-in problems and that the full performance level that the Parties agreed will be delivered from day one, is indeed delivered from day one, even if the road or prison is opened in phases. In the case of such phased Service Commencement, the amount of the Unitary Payment must be ramped up proportionately to reflect the phased Service Commencement.[196]

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[195] See Part H:38 (*Payment and Financial Matters: Reporting Requirements*).

[196] See Part E:20.1.5 (*Duration and Service Commencement: Acceptance and Service Commencement*).

33.4.2 One approach, which gives flexibility in the settling-in period, is to allow the Private Party to accrue a lower number of Penalty Deductions during that period than would accrue during the remainder of the PPP Agreement. Some projects (for example, where the Services involve a relocation from existing Facilities into new Facilities) have made successful use of agreed performance levels where Private Parties are allowed a three to six months settling-in period. During this time monitoring takes place, but any Penalty Deductions imposed on the Private Party for poor performance are set at a lower level than is the case once operations are fully established (but, in such cases, this does not affect the Institution's rights to terminate for Private Party Default). A third approach is to award Penalty Deductions at the rate provided for in the PPP Agreement so that the Institution only pays for that portion of the Services which is available while increasing the threshold at which Penalty Deductions will trigger termination, thereby providing some relief to the Private Party.

33.5 **Replacement of Subcontractors**

33.5.1 Altering the performance regime is not appropriate in the case of replacement of Subcontractors, as it is the Private Party's responsibility to manage its Subcontractors and thus the Private Party should bear the risk of their poor performance. The Institution should not be disadvantaged by any change in Subcontractors, so the performance regime should not be interrupted by any such change.

33.5.2 Nevertheless, the Institution should allow the Private Party to replace its Subcontractors (subject to the Institution's right to pre-approve the replacement Subcontractors)[197], in order to improve performance and avoid termination. To enable it to do so, the Private Party will normally set a stricter termination threshold (or trigger termination at an earlier point in time) in its Subcontracts than that which applies in the PPP Agreement.

[197] See Part S:83.2 (*Miscellaneous: Subcontracting*).

33.5.3 However, if the Penalty Deductions have already accrued to a level where a minor default could trigger termination, the Private Party may find it impossible to attract a replacement. In projects where there is only one Subcontractor (or even two Subcontractors) and where the pool of available replacement subcontractors is small, the Institution should permit the suspension of the accrual of further Penalty Deductions for the purposes of termination only (and not for the purposes of deductions from the Unitary Payment) for a limited period of time[198] after the replacement Subcontractor has been appointed (a "settling-in" period). In order to avoid this relief from termination being abused, the PPP Agreement should prohibit the Private Party from invoking this relief more than twice in the Project Term.

33.6 **Who Does the Monitoring?**

33.6.1 A key issue to be resolved is who will do the monitoring: the Institution, the Private Party, the Parties acting jointly or an independent third party?

33.6.2 Monitoring should occur at three levels:

33.6.2.1 a systematic self-monitoring by the Private Party through a quality management system measuring performance;

33.6.2.2 a review of the Private Party's quality management system by the Institution (or an independent third party) including a combination of certain scheduled and random spot checks (with an ability to increase monitoring on repeated failure or poor performance); and

33.6.2.3 the ability for users to report failures (for example, clinical staff and service personnel).[199]

33.6.3 Whatever the system that is agreed on, this must be incorporated into the PPP Agreement so that the process by which Penalty Deductions are

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[198] This period should be long enough to attract a replacement subcontractor and enable it to rectify the failure but still be short enough to incentivise the Private Party to remedy the defect quickly.

[199] If the staff are employed by the Private Party this may create a conflict of interest and may not be appropriate.

made is clear and unambiguous. There should be no debate as to whether an event is a failure and subject to a deduction.

33.6.4 Monitoring is ultimately the responsibility of the Private Party. This will usually be dealt with as part of the quality management system run by the Private Party. Mechanisms must be in place to ensure that the Private Party collects and provides data accurately. Failure by the Private Party to adequately self-monitor should in itself result in Penalty Deductions. The method of self-monitoring which the Private Party will use must be agreed on with the Institution in order to ensure that such a self-monitoring system accurately captures any unavailability or lack of performance in delivery of the Services. It is essential that the Institution satisfies itself that the self-monitoring system proposed by the Private Party is adequate, since the data collected using this system will ultimately be used to calculate the Penalty Deductions. Where a Private Party provides the information, such information should be in a format stipulated by the Institution[200] who should obtain a right of review (for itself or through an independent third party) to verify the information.

33.6.5 The obligation of the Private Party to self-monitor its performance of the Services should not be confused with the Institution's obligation to monitor in terms of its statutory obligations. Pursuant to Treasury Regulation 16, an Institution is required to demonstrate in its application for TA:I that it has the capacity to monitor the implementation and performance of a PPP Agreement. Mechanisms and procedures for such performance monitoring must be established by the accounting officer or the accounting authority of an Institution even before the PPP Agreement has been executed in order to ensure that the PPP Agreement is properly enforced. Accordingly, the Institution must ensure that sufficient resources and staff with the right level of experience are available to manage and monitor the PPP Agreement. Some PPP Agreements have

[200] The Institution must ensure that this is consistent with the Auditor-General's requirements. See Module 7: Auditing PPPs.

provided for joint training and development of Institution and Private Party staff to encourage partnership.

33.7 **Who Pays for the Monitoring?**

33.7.1 As a substantial portion of the monitoring is self-monitoring, the Private Party should bear the costs of monitoring. In respect of any reviews of the monitoring systems by the Institution, the Institution should bear the costs. However, in the event that the review reveals that the monitoring systems are defective and the output specifications are not being met, the Private Party should bear the costs of that review.

33.7.2 The monitoring arrangements should be proportional to the consequences of Services failure. This will ensure that where it is possible to have a less onerous system it will be in both Parties' interests to do so. Equally, where the consequences of failure are severe, for example, hygiene in an operating theatre, then a rigorous monitoring system should be specified.

33.8 **Addressing Qualitative Factors**

Objective performance criteria should always be used as far as practicable, but other methods of measuring performance may be appropriate in some specific Projects. For example, in some Projects there may be qualitative aspects of performance to which it may be difficult to apply Penalty Deductions objectively, but which are nevertheless important to the users of the Services, such as the helpfulness of staff or the quality of catering. Three possible approaches for measuring these aspects of performance are the use of end-user satisfaction surveys, the use of "mystery shoppers" and sampling:

33.8.1 *End-user satisfaction surveys*[201] – it is difficult to base financial compensation on end-user satisfaction surveys because they are based on individuals' perceptions rather than on objective measurable facts and so the results of such surveys may vary. However, over time they are a useful way of monitoring performance. The Private Party could be

[201] The questions should be carefully drafted in order to achieve a meaningful response.

obliged in terms of the PPP Agreement to improve end-user satisfaction and, where a survey reveals that a particular aspect of the Services falls below the agreed level, it would have to implement a rectification plan which should be agreed with the Institution. The advantage of such a system is that if end-users clearly understand the quality of Services contracted for, the feedback obtained can be very useful.

33.8.2 *Mystery shoppers* – a similar approach could be adopted with "mystery shopper" surveys (that is, the use of qualified individuals to test aspects of the Services). This removes the perception aspect of testing since the relevant individuals will apply the same objective standards to all aspects of the Services tested.

33.8.3 *Sampling* – where monitoring is to be done on a sampled basis, the methodology for sampling, including sample size and frequency, should be agreed prior to the Signature Date.

Certain Projects do not lend themselves particularly to any of these approaches. Regardless of which method is used, the quality of Services must be considered in detail by both Parties and included in the PPP Agreement.

33.9 Monitoring of Subcontractors

33.9.1 An Institution may feel the need to use the PPP Agreement to allow it to intervene at Subcontractor level to protect its interests when a Subcontractor is performing poorly (for example, the Institution may want the right to direct or require the replacement of the Subcontractor). This approach is not recommended as it should be for the Private Party to manage its Subcontractors and thus intervention by the Institution will affect the degree of risk transfer achieved. Similarly the Institution should not seek to obtain any direct undertakings or guarantees from the Subcontractors. The Institution should instead rely on the payment mechanism, termination and its other rights in the PPP Agreement as against the Private Party to address poor performance by the Subcontractors.

33.9.2 Penalty Deductions under the payment mechanism and, ultimately, the risk of the Institution terminating the PPP Agreement, should be a sufficient incentive for the Private Party to manage its Subcontractors' performance. The Private Party will typically ensure it has the right, under the Project Documents, to replace its Subcontractors before the Institution's right to terminate arises under the PPP Agreement. Concerns regarding Subcontractors' performance may be further addressed in the PPP Agreement by requiring a temporary increase of monitoring at the Private Party's expense in specified circumstances as well as requiring the Private Party to provide an acceptable plan outlining how any defects in the Services will be remedied. Both of these measures impose costs on the Private Party and are only acceptable if there has been a persistent and verifiable period of unavailability or poor performance.

33.10 **Reporting the Results of Performance Monitoring**

33.10.1 The PPP Agreement will need to specify the way in which information regarding performance is reported. Wherever possible, monitoring should allow co-ordination of report production in a way that avoids duplication of effort and all Project participants (including the Lenders) should consider carefully what is needed. The key issues which have to be considered are:

33.10.1.1 what reports are required? By whom? How frequently? Are different reports required by different people in the organisation, for example, contract manager, chief executive officer and so forth?

33.10.1.2 is there to be a standard monitoring form or an IT compatible format to present results?

33.10.1.3 how soon after a monitoring period is the report to be received?

33.10.1.4 how often are meetings required between the Institution and the Private Party? Who is required to attend from either Party?

33.10.2 Penalty Deductions imposed in respect of a specific failure should be the Institution's exclusive remedy in respect of that failure (except to the extent that any termination rights depend on levels of accrued Penalty Deductions or the PPP Agreement provides for other specific remedies, such as indemnities). The levying of Penalty Deductions will, however, not relieve the Private Party from its obligations to remedy the defect or from any of its other obligations under the PPP Agreement.

33.11 Consequences of Poor Performance

33.11.1 The PPP Agreement must set out clearly the consequences of any failure by the Private Party to perform to the minimum standards of the required output specifications.

33.11.2 One approach is for the Private Party to incur a specified number of Penalty Deductions for each failure, with the level of deductions incurred varying according to the seriousness of the failure. The value of the Penalty Deductions should be set based on commercial considerations as opposed to the cost of providing the Services. The PPP Agreement would in this case include a schedule setting out in detail the level of Penalty Deductions imposed for each failure to meet a required output specification. There should be a clear link between the seriousness of the failure, the value of Penalty Deductions accrued and the potential financial impact on the Private Party. For example, a failure to clean the exterior of the windows in a hospital should not accrue as high Penalty Deductions as a failure to maintain the operating theatre in the specified condition. Similarly, different failures in respect of the same part of the Services may also incur different Penalty Deductions depending upon the context in which they arise. For example, a failure to deliver food in a suitable condition is a more serious failure than a failure to serve food wearing a waiter's uniform.

33.11.3 Depending on the type of payment mechanism used, a failure may or may not have an immediate financial impact on the Unitary Payments payable by the Institution.[202] It is possible for Penalty Deductions to only start once performance deteriorates below a particular level or alternately for them to accrue on the first failure.

33.11.4 In some projects it will be more appropriate to have a ratchet mechanism to deal with persistent failure to render a particular aspect of the Services. A simple ratchet mechanism could involve increasing the level of Penalty Deductions awarded for a particular failure in the Services that recurs too often within a specified period. For example, if Penalty Deductions equal to x are made for a failure to achieve a particular output specification then Penalty Deductions equal to (x+3) may be made for each failure over and above a specified maximum number of failures within a pre-defined period.

33.11.5 The ratchet mechanism can be particularly useful where the financial cost of Penalty Deductions which accrue in respect of each such failure is insufficient to provide an appropriate incentive on the Private Party to rectify the failures. A key advantage of the ratchet mechanism is that poor performance which continues for a significant period will be more difficult for other Project participants (for example, Subcontractors and the funders) to ignore, thereby encouraging early action by the Private Party.

33.11.6 If the ratchet mechanism is overly complicated it will be difficult to manage while the inclusion of onerous measures in the pricing mechanism can affect value for money. It is important to tailor the ratchet mechanism to a particular Project in a way that produces the best value for money. In establishing a suitable system, the Institution will have to be aware of the effect a particular system has on the proposal offered by a bidder. For example, a bid proposal that is capital intensive up-front with reduced consequential life cycle costs will have one optimum approach, whereas one with lower up-front capital costs but

[202] This will depend on the type of payment mechanism used.

with higher life cycle costs will have a different optimum approach (that is, they are most effective at different points in the respective financing plans). It is crucial for the Institution to understand what level of commercial hardship experienced by the Private Party (through the ratchet mechanism) will best achieve the result it desires. An overly rigid approach during negotiations will reduce the scope for innovation by the bidders and so reduce the potential for best value for money to be achieved.

33.11.7 The payment mechanism should as far as possible cover every aspect of the Services. Where all-encompassing performance standards are not feasible or do not sufficiently address persistent failures, the Institution should consider what recourse it should have against the Private Party for sub-standard performance that is not covered under the required performance standards (see Part N:(*Termination*)).

33.12 **Security for Service Obligations**

Security for the obligations of the Private Party to perform the Services in the form of a performance bond during the Service Period is not necessary (excluding the last few years if there is provision for a final maintenance bond). Having a bond in place for a period as lengthy as the Service Period is costly and may impact negatively on value for money considerations. The cost is rarely justifiable when one considers that the Institution is entitled to make Penalty Deductions from the Unitary Payment for unavailability and poor performance.

PART G: PROJECT ASSETS

34 EQUIPMENT AND MATERIALS

34.1 The procurement of the equipment and materials included in the Project Assets and their availability for achieving the required output specifications is a type of "availability risk", which must be borne by the Private Party during the Project Term. Therefore, the Institution should generally not be prescriptive about the types of equipment and materials to be used in the Project or the methods (often described as "method statements") to be used to satisfy the output specifications in the PPP Agreement.

34.2 The PPP Agreement must state that all equipment and materials that are to be used in the provision of the Services should be of a satisfactory quality and meet all relevant statutory requirements and the appropriate SABS or equivalent specifications and/or codes of practice. In managing the issue of "quality" and to avoid any confusion during the Project Term, quality issues must be decided prior to the Signature Date and incorporated into the PPP Agreement.

Standard Clause

<u>Equipment Standards</u>

The Private Party shall ensure that the goods, equipment, consumables and materials used by it or any Subcontractor in connection with the provision of any of the Services (each as a distinct and separate obligation) are:

(a) maintained in a safe, serviceable and clean condition in accordance with Good Industry Practice;

(b) of the type specified in the service level specifications and/or the method statements (where appropriate);

(c) in compliance with any relevant rules, regulations, codes of practice and/or South African standards; and

shall, as soon as practical after receiving a request from the Institution, supply to the Institution evidence to demonstrate its compliance with this Clause.

34.3 The PPP Agreement must also make provision for the treatment or storage of any necessary hazardous materials, substances and equipment. It should oblige the Private Party to ensure that all hazardous materials, substances and equipment used or stored on the Project Site are kept in accordance with all applicable law and Good Industry Practice, properly and securely labelled and stored, under appropriate supervision and used only by appropriately trained and competent staff. Furthermore, the Private Party should use all practical and reasonable means to prevent or counteract any unlawful emissions, unlawful discharges or unlawful generation, accumulation or migration of any hazardous substances at or from the Project Site and prevent any circumstances arising which are likely to result in any environmental claims.[203]

34.4 Alternatively, the PPP Agreement should prohibit the installation, keeping and use of any hazardous materials, substances and equipment not necessary for the provision of the Project Deliverables if these may cause damage to the Facilities or bodily injury, endanger health and safety, or may have the effect of transferring the risk associated with them to the Institution.

34.5 In certain Projects, consumables may be acquired by the Institution for use in the Project Assets, for example a cartridge (being the consumable) in a printer (being the Project Asset). The PPP Agreement should set a minimum standard for these consumables and, provided that the consumables acquired by the Institution comply with this standard, the Private Party will continue to remain liable for the proper functioning of the Project Asset concerned.

35 REPLACEMENT AND UPGRADING

35.1 The replacement of obsolescent (used here in the sense of being obsolete to the required output specifications) or "out-of-date" Project Assets is part of the availability or operational risk that should be assumed by the Private Party.

35.2 The Lenders will often require that the Private Party adhere to a replacement programme. In its due diligence, the Institution should ascertain whether this is indeed the case, as the existence of such a programme will provide some comfort to the Institution regarding the Private Party's ability to fulfil its obligations in terms of the PPP Agreement.

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[203] See Part D:14.2 (*Project Site: Environmental Risks*).

35.3 As a general rule, therefore, the Institution should not seek to impose an obligation on the Private Party to replace the Project Assets in accordance with a specific replacement programme or be prescriptive regarding the timing or manner of replacement. The Private Party will, however, usually have a replacement programme, detailing in respect of each category of Project Assets, for the Project Term, projected replacement and/or upgrading tasks, dates and costs.

35.4 In exceptional circumstances the Institution may require that the Private Party adhere to a replacement programme. These would usually be circumstances where the Lenders have not insisted on a replacement programme or in certain types of projects, such as IT projects involving health or medical equipment where there are rapidly changing standards and a high risk of obsolescence.

35.5 Even in these exceptional circumstances it is important for the Institution to remember that it will have no recourse in the event of non-compliance with the replacement programme. The Institution will only be entitled to levy Penalty Deductions if the output specifications have not been met. The only benefit of a replacement programme is that non-compliance provides the Institution with an early warning.

Standard Clause

Project Assets: General Obligations

The Private Party shall at its own cost and risk, provide, deliver, install, commission, manage, maintain, repair, renew and replace (as the case may be) the Project Assets (or part thereof) at such times and in such manner:

(a) as to enable it to meet the [output specifications] for the Project set forth in Schedule [x];

(b) as to ensure that the Private Party is, at all times, able to provide Services;[204]

(c) without limiting Clause (i) above, as would be required having regard to Good Industry Practice; and

[204] It may be appropriate, depending on the particular project, to provide that the Services be rendered using "state of the art" equipment and systems. This requirement does, however, have cost implications and may result in the project being too expensive to ensure value for money for the Institution. If this requirement is adopted, then the term "state of the art" must be defined. The Institution should seek the advice of its technical advisors in this regard.

(d) *as required by law.*

35.6 The Institution should consider whether or not any replaced Project Assets could be utilised by the Institution at other facilities (not forming part of the Project) under its control. For example, replaced Project Assets at a tertiary level hospital could be utilised at other hospitals where they may be needed. If so, then the Institution should ensure that the PPP Agreement provides for appropriate acquisition terms and a methodology for valuing the replaced Project Assets.

36 SECURITY OVER PROJECT ASSETS

36.1 Project Assets Not Already Belonging to the Institution

36.1.1 The Institution should carefully consider which, if any, of the Project Assets it will require at the end of the Project Term in order to continue provision of the services. These are likely to be those Project Assets that are essential or critical for the ongoing provision of the services. During the procurement phase of a project, the Institution must notify the bidders of the Project Assets that it will require at the end of the Project Term by identifying such Project Assets, whether individually or by category or class, so that this may be priced into the bids that are submitted.

36.1.2 Any Project Assets that the Institution requires at the end of the Project Term should not be available to the Lenders as part of their security package but may form part of the Institution's security package. This will, however, be reflected in the cost of the Debt. The Institution must, therefore, on a project-by-project basis, assess the situation taking into account value for money and affordability considerations. Any Project Assets not identified by the Institution as contemplated in Section 36.1.1 may form part of the Lenders' security package.[205]

36.1.3 If the Institution has informed the Private Party that it wishes to take over any Project Assets at the end of the Project Term, it may require security

[205] See footnote 264.

over such Project Assets in order to protect its interests in them against the Private Party's other creditors. Specific legal advice should be sought by Institutions wishing to take any security interests over any such Project Assets regarding the nature of the security that would be appropriate. In the case of tangible movable Project Assets, specific advice should be sought regarding the appropriateness and practicality of registering a general notarial bond as opposed to a special notarial bond, particularly if these Project Assets are likely to be replaced often during the Project Term.

36.2 **Institution Assets**

36.2.1 Pursuant to section 3 of the State Liability Act, 1957, no execution, attachment or like process may be issued against any physical state property. That Act does not expressly define "state", but it would appear to exclude (for the purposes of that Act) any public entities that are not financed substantially from the National Revenue Fund or a Provincial Revenue Fund, that is, "government business enterprises" as defined in the PFMA. Accordingly, the giving of security (whether to the Private Party or the Lenders) in the form of a bond over physical Institution Assets of all Institutions (other than government business enterprises) will not be enforceable.[206]

36.2.2 As regards any non-physical property of such Institutions and all property of any government business enterprises that may be made available (as Institution Assets) to any Private Party under PPP Agreements, the prescribed approach in this Standardisation is that Institutions should not grant any security whatever over any such Institution Assets to secure their payment obligations under PPP Agreements.

36.2.3 It should be borne in mind that the State Liability Act, 1957 regulates the specific issue of the *enforcement* of security over physical state property. The primary legislation regulating the *giving* of security by any organ of

[206] Such Institutions should bear in mind, however, that the amount required to satisfy any judgment or order made against any such Institution may be paid out of the relevant Revenue Fund.

state in the national or provincial spheres of government is the PFMA (more particularly, chapter 8 of the PFMA). Non-compliance by any Institution with chapter 8 of the PFMA in relation to the grant of any security will render the security *invalid*.

36.3 As regards the giving of security by Institutions to Private Parties (or their funders) to secure their payment obligations in respect of Unitary Payments or termination compensation, see Part H:37.6 (*Payment and Financial Matters: Security for Institution Payments*).

PART H: PAYMENT AND FINANCIAL MATTERS

37 UNITARY PAYMENTS

37.1 Introduction

The PPP definition in Treasury Regulation 16 requires the receipt by the Private Party of a "benefit" for performing the Services or pursuant to its use of any Institution Assets. These benefits must be either in the form of compensation from a Revenue Fund or the Institution's own revenues (referred to in this Standardisation as a "Unitary Payment") or user charges or both.

37.1.1 Revenue Fund

37.1.1.1 In terms of the Constitution, no funds may be withdrawn from the National Revenue Fund or a Provincial Revenue Fund unless "appropriated" in terms of an Act of Parliament or a provincial Act, as the case may be, or as a "direct charge" that is provided for in the Constitution or an Act of Parliament, or provincial Act, as the case may be.[207]

37.1.1.2 The PFMA does not make any provision for Unitary Payments to be treated as direct charges. Accordingly, the funds required by an Institution (other than a government business enterprise)[208] from the relevant Revenue Fund to make any Unitary Payments that may become due in any financial year must be "appropriated" by the relevant legislature in terms of an Appropriations Act relating to its budgeted requirements for that financial year.[209]

[207] See sections 213 and 226 of the Constitution.

[208] Government business enterprises are excluded here because they are not financed (wholly or substantially) from a Revenue Fund, but from their own business operations.

[209] Section 38(2) of the PFMA prohibits the accounting officers of national and provincial departments and constitutional institutions from committing to any liability (for instance, pursuant to a PPP Agreement) for money which has not been so appropriated.

37.1.1.3 In relation to any PPP Agreement to which a departmental Institution is a party, the accounting officer of that Institution is responsible for, among other things:

(a) reporting to the relevant Treasury at the beginning of each financial year, all expenditure commitments under that PPP Agreement anticipated in that financial year;

(b) ensuring that such expenditure commitments are incurred in accordance with the vote for that Institution in the Appropriations Act for that financial year; and

(c) preventing irregular and unauthorised expenditure by that Institution.[210] If the expenditure commitments of a departmental Institution under a PPP Agreement are not covered (whether at all or sufficiently) in the relevant vote and such expenditure is nevertheless incurred, it will be classified either as “unauthorised expenditure” or “irregular expenditure”.[211]

37.1.1.4 In the case of a public entity (other than a government business enterprise), its accounting authority is responsible for, among other things:

(a) ensuring that its expenditure commitments under a PPP Agreement in any financial year are included in its budget for that year when that budget is submitted to its executive authority for its approval;[212]

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[210] Section 38(1)(c)(ii) and Section 39(1)(b) of the PFMA.

[211] Section 1 of the PFMA defines “unauthorised expenditure” as an “overspending” (that is, when expenditure exceeds the amount appropriated for the vote or main division of a vote to which that expenditure relates) of a vote or a main division in a vote, or expenditure that is not in accordance with the purpose of a vote or main division of a vote. In contrast, “irregular expenditure” is defined as expenditure that is incurred in contravention of or not in accordance with a requirement of any legislation applicable to the public entity, save for unauthorised expenditure.

[212] See section 53(1) of the PFMA. The budget must be submitted through the accounting officer for the department designated by the executive authority accountable for that public entity at least six months before the commencement of the financial year.

(b) ensuring that such expenditure is incurred in accordance with that budget;[213] and

(c) preventing irregular expenditure.[214]

37.1.1.5 In the case of a government business enterprise:

(a) its expenditure commitments in any financial year arising under a PPP Agreement must be included in its annual budget for that financial year submitted to the accounting officer designated by the executive authority responsible for that government business enterprise;[215] and

(b) its accounting authority is responsible for preventing irregular expenditure.[216]

37.1.1.6 Institutions should therefore ensure that their expenditure commitments for Unitary Payments required to be made under any PPP Agreements to which they are party are adequately budgeted for in accordance with the requirements of the PFMA.

37.1.2 <u>User Charges</u>

37.1.2.1 Certain PPPs entail the provision of Services to customers or end-users in exchange for tolls, tariffs or other similar charges, for example, a toll road.

37.1.2.2 The setting, levying and collection of any user charges generated under a PPP Agreement must meet the requirements for tariff setting and collection in the PFMA and the Treasury Regulations, as well as any sector-specific legislation applicable to a PPP, for example, in the case of a PPP for the operation of a national toll

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213 Section 53(4) of the PFMA.

214 See section 51(b)(ii) of the PFMA.

215 The budget must also be submitted to the relevant Treasury at least one month before the financial year starts. See section 52 of the PFMA.

216 See section 51(b)(ii) of the PFMA.

road, The South African National Roads Agency Limited and National Roads Act, 1998 (the "**National Roads Act**").

37.1.2.3 Tariff setting by Institutions (other than public entities) is partly governed by Treasury Regulation 7, which places a duty on the accounting officer of any such Institution to review annually all its tariff-setting structures "that are not or cannot be fixed by any law" when finalising its annual budget and obtaining the approval of the relevant Treasury for any proposed tariff-setting structure.[217] Apart from this, neither the PFMA nor the Treasury Regulations regulate tariff setting by public entities. Instead, this is generally regulated by the sector-specific legislation applicable to the public entities concerned. For example, in the case of SANRAL, the National Roads Act places responsibility on the Minister of Transport to set the amount of any toll that may be levied and collected at a national toll road (whether operated by SANRAL or by a Private Party).[218]

37.1.2.4 The PFMA and the Treasury Regulations do, however, extensively regulate tariff levying and collection from a cash and revenue management perspective. The PFMA imposes a general duty on accounting officers and accounting authorities of Institutions to take effective and appropriate steps to collect revenues due to the relevant Institution and to prevent the under-collection of such revenues.[219] These provisions do not prevent the delegation by any Institution of the levying and collection of user charges, for instance, to a Private Party pursuant to a PPP Agreement. However, Institutions remain responsible for ensuring that the levying and collection activities assumed by a Private Party are

[217] The relevant Treasury for the purposes of Treasury Regulation 7 is not necessarily the relevant Treasury for the purpose of Treasury Regulation 16.

[218] See section 27(3) of the National Roads Act. SANRAL, as the Institution, may make recommendations to the Minister regarding the setting of the toll, rebates or increases and reductions in the toll, but does not have the power to set the toll.

[219] Sections 38(1)(c)(i) and 51(b)(i) of the PFMA. The cash management provisions of Treasury Regulation 15 (applicable to departments and constitutional institutions) and Treasury Regulation 31 (applicable to public entities) impose a duty on the accounting officer or accounting authority, as the case may be, of such an institution to among other things, collect revenue when due and pursue debtors so as to ensure prompt collection.

consistent with the minimum standards for effective cash and revenue management imposed on the Institution by the PFMA and the Treasury Regulations as well as any sector-specific legislation.

37.1.2.5 In contrast to collection, and as a general rule, tariff setting may not be delegated to a Private Party. Simply stated, this means that an Institution may not agree in its PPP Agreement to delegate any discretion it has to set tariffs to a Private Party.[220] If the Parties to the PPP Agreement require that tariffs be set at a specified level and/or for periodic adjustments in the tariffs at specified intervals and within specified levels, then they should instead consider providing in the PPP Agreement that the Institution will make good any direct losses incurred by the Private Party if the actual tariffs set by government at any time are less than the specified tariffs in the PPP Agreement (including adjustments).

37.1.3 <u>Benefits payable to the Institution</u>

37.1.3.1 Treasury Regulation 16 does not expressly require the receipt by an Institution of any fee, rental or other consideration in connection with a PPP which may sometimes be feasible, particularly where a PPP involves the use of substantial revenue-generating Institution Assets, for example, toll road and eco-tourism projects.

37.1.3.2 However, if a PPP entails the lease of Institution Assets by an Institution (other than a public entity), then the provisions of Treasury Regulation 10.2.3 will apply. This Treasury Regulation requires that the letting of state property by such an Institution pursuant to “operating leases” (as opposed to “finance leases”)[221]

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[220] This is because tariff setting is a legislative function, which government is constitutionally prevented from “fettering” by agreement. There are limited exceptions to this fettering rule. An Institution considering such an agreement for any PPP in which user charges are a source of revenue generation for the Private Party, should obtain specific legal advice in this regard.

[221] See footnote 18 for a brief explanation of these two concepts.

shall be at "market-related" tariffs, unless the relevant Treasury specifically approves otherwise.[222]

37.2 **Payment Mechanism in General**[223]

37.2.1 The payment mechanism is the essence of the PPP Agreement as it puts into financial effect the risk allocation between the Institution and the Private Party. It determines the Unitary Payments that the Institution makes to the Private Party and establishes the incentives for the Private Party to make the Services available in a manner that provides value for money. This Section 37 (*Unitary Payments*) must be considered in conjunction with Part F:23 (*Services*).

37.2.2 In general terms, the key features of a payment mechanism must be that:[224]

37.2.2.1 no Unitary Payment should be made until the Services are available (but see Part F: (*Services*) for when the Institution may accept incomplete Services);

37.2.2.2 there should be a "single" or "unitary" Unitary Payment for the Services in the sense that the payment should not comprise categories that are linked to the delivery of inputs (for example, labour and material costs), although such categories may be taken into account in relation to permitted inflationary increases (see Section 37.2.4);

37.2.2.3 the Unitary Payment should only be paid to the extent that the Services are available; and

37.2.2.4 the payment mechanism should seek to make deductions for unavailability and poor performance so that the Private Party is

222 See also Treasury Regulations 13.2.3 and 32.2 and section 76(1)(k) of the PFMA.

223 See the assumption at (B1.1) in the Preface.

224 This Standardisation focuses primarily on projects in which the consideration for the Services is paid by the Institution from a Revenue Fund or its own revenue sources rather than on projects where the consideration is derived from user charges or tariffs, for example, toll roads. The payment mechanism for the latter kind of projects should be considered on a project-by-project basis, subject to legislative requirements.

penalised financially, but deductions should reflect the severity of the failure, so that no Services[225] should lead to no payment, but a minor failure should only cause at most a minor deduction. These should be cumulative so that persistent failures may increase the level of deductions.[226]

37.2.3 The Unitary Payment should always be linked to performance and/or availability of the Services.[227] It should not contain a fixed portion to which the Private Party is entitled irrespective of availability or its performance.[228]

37.2.4 In respect of the Services, the Institution should agree upon a fixed Unitary Payment over the lifetime of the Project, subject only to certain inflationary increases. The inflation risk arising in relation to any project must be considered on a project-by-project basis. The following general principles apply:

37.2.4.1 this risk should be shared between the Institution and the Private Party;

37.2.4.2 if there is no inflation-indexation mechanism, the Private Party is likely to incorporate a contingency into its price, which is unlikely to give the Institution value for money; and

37.2.4.3 CPIX is the recommended indexation mechanism for PPPs with a Unitary Payment type mechanism given that annual increases in the budgetary allocations for governmental institutions are based on CPIX. However, whether CPIX is the appropriate indexation mechanism for any PPP should be determined not only with reference to affordability but also value for money considerations.

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[225] This may not mean a total absence of Services but is based on the availability criteria.

[226] See Part F:23 (*Services*).

[227] This is also applicable when the Private Party's revenue is determined by volume or usage as in the case of a toll road project where the revenue is the aggregate of the tolls that the Private Party is able to recover from road users. The volume risk should however always be borne by the Private Party unless value for money considerations dictate otherwise on a project-by-project basis. It may be possible to agree with the Private Party that any upside in excess of an agreed percentage be shared with the Institution in terms of a pre-determined formula.

[228] Such as a minimum portion required to enable the Private Party to meet its debt service obligations to the Lenders.

Institutions should consider alternative indexation mechanisms at the feasibility study phase of their PPPs (with reference to affordability and value for money considerations). Whichever index is selected, the choice of index must be specified in the RFP. The Parties may agree on a different index or basket of indices provided that the agreed index or basket of indices is reflected in the PPP Agreement as the applicable index/indices for the duration of the Project Term. In agreeing to an index or basket of indices, the Institution must ensure that the relevant index or basket of indices can be easily calculated, and that only indices that are published in South Africa are used.

37.2.5 Save for inflationary increases, there should be no other increases of the Unitary Payment. The Private Party may seek to re-assess the Unitary Payment or specified portions of it at pre-determined intervals during the Service Period in order to mitigate its risk that unforeseen circumstances during the Project Term may result in the Unitary Payment being insufficient to cover its costs and yield anticipated profit margins. This should be resisted given its likely negative impact on value for money and affordability.

37.2.6 To the extent that the output specifications are amended resulting in an increase in the Unitary Payment, this should be dealt with in terms of the Variation Clause.[229]

37.2.7 Depending on the specifics of the particular project, it may also be necessary to provide for "Additional Costs" and "Pass Through Costs".

37.2.7.1 Pass Through Costs constitute costs that are incurred by the Private Party and which the Institution has undertaken to pay. For administrative reasons, it may, however, be agreed between the Parties that the Private Party will pay these Pass Through Costs to the Responsible Authority and that the Institution will reimburse

[229] See Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*).

the Private Party. To the extent that there are any such Pass Through Costs, these must clearly be stipulated in the PPP Agreement together with the procedure for invoicing such costs. These costs will not include any mark-up by the Private Party or any administrative or handling charges. They are direct Pass Through Costs paid by the Private Party for which the Institution will reimburse the Private Party.

37.2.7.2 Additional Costs relate to costs for which the Parties agree that the Institution will reimburse the Private Party. Such reimbursement may include a mark-up on the costs. Alternatively it may only be equivalent to a portion of the costs incurred by the Private Party.

37.2.8 The Institution should ensure that the Unitary Payment is made timeously and is not unreasonably withheld. Any unreasonable delay in payment of the Unitary Payment should attract interest at the Default Interest Rate.

37.3 **Penalty Deductions**

37.3.1 If the Private Party fails to perform there can be both direct and indirect approaches to remedy the failure.

37.3.2 The direct approach involves deductions from the Unitary Payment and is linked to the availability of the Services (see Part F: (*Services*)). For example, if certain prison cells or hospital rooms do not meet the relevant availability definition, then an Availability Deduction may be made from the Unitary Payment. The test should be whether the Services are available and not whether they are used. The Private Party should be incentivised to rectify the default itself. Unavailability for a prolonged period may trigger termination.

37.3.3 The indirect approach depends on the level of performance of the available Services (see Part F:33 (*Services: Performance Monitoring*)) and involves poor performance being addressed by Performance Deductions which will vary according to the seriousness and regularity (if a ratchet mechanism is used) of the poor performance.

37.3.4 Once unavailability or performance deteriorates below a certain level (whether for a single failure or for persistent failure under a ratchet mechanism), or Penalty Deductions reach a certain level, then a range of other remedies can be invoked, from formal warnings that could lead to eventual termination for a Private Party Default.

37.3.5 As Penalty Deductions not only result in financial deductions from the Unitary Payment but could also result in termination once a pre-determined threshold has been reached, the Private Party often seeks to have the Penalty Deductions lapse or fall away for the purposes of termination after a certain period of time. While it is in both Parties' interests to ensure that the Project does not "limp along" indefinitely due to poor performance, the Institution should, on a project-by-project basis, assess whether it is feasible to have Penalty Deductions accumulate indefinitely for the purposes of termination or whether there is any merit in having them lapse or expire for termination purposes after a specified time period.

37.3.6 A combination of deductions for unavailability and under-performance may be used to address failure by the Private Party. Care should be taken, however, to avoid deductions of both types in respect of the same failure.

37.3.7 Penalty Deductions imposed in respect of a specific failure should be the Institution's exclusive remedy in respect of that failure except to the extent that termination rights depend on levels of accrued Penalty Deductions or the PPP Agreement provides for other specific remedies such as indemnities. Therefore, failures that are covered by Penalty Deductions should not entitle the Institution to termination rights for any other reason, for example, material breach.

37.4 The Payment Mechanism

37.4.1 In practice, a variety of payment mechanism structures have been used across sectors and project types (from availability-based mechanisms to service-based and usage-based mechanisms).

37.4.2 A possible model is one that provides a Unitary Payment structure, focusing on broad accommodation areas, rather than individual places for the Services required. The Unitary Payment is then based on a full provision of the overall Services so that the payment mechanism simply determines the deductions for unavailability or poor performance. Availability is defined in terms of being usable and accessible (according to agreed specifications) and different Availability Deductions are made depending on which area is unavailable. For example, in a hospital project, each section of the hospital may be divided into units and given a weighting depending on its importance. For each failure to provide an available unit there is initially an Availability Deduction equal to the Unitary Payment multiplied by the relevant weighting. The Availability Deduction can be based on an escalating tariff so that subsequent days of unavailability of the same space may lead to progressively higher deductions. A similar system can be used for poor performance and the resultant accrual of Performance Deductions.

37.4.3 A second possible model is one which follows the principles set out in Part F:33 (*Services: Performance Monitoring*). The Unitary Payment is based on the number of available places or units so that only places or units that are available are paid for. The definition of available places or units incorporates ongoing core Services, and thus the deduction regime is only used to address levels of performance which impact on the availability of places and/or services that are within the definition of the core Services, with poor performance leading to Performance Deductions from the Unitary Payment.

37.4.4 The PPP Agreement should stipulate a procedure for the invoicing of Unitary Payments including the manner of payment, currency of payment (which must be in Rand), interest on late payment and whether the Unitary Payments are inclusive or exclusive of VAT (See Part S:85 (*Miscellaneous: Taxation*)).

Standard Clause

Payment

(a) *Unitary Payment*[230]

The Private Party shall not be entitled to receive any Unitary Payment until the Service Commencement Date.[231] *Subject to the provisions of this PPP Agreement, the Institution shall pay the Private Party the Unitary Payment with respect to all Services each [period]*[232] *following the Service Commencement Date in accordance with the provisions of Schedule [x].*

(b) *Payment Deductions*

Penalty Deductions from the Unitary Payments shall be made as required by Schedule [x].

(c) *Invoicing and Payment Arrangements*

The invoicing arrangements with respect to Unitary Payments and other payments shall be as follows:

(i) *The Unitary Payment shall accrue in arrears in respect of each [period]*[233] *and shall be invoiced and paid in the following [period].*

(ii) *On the [x]th Business Day of each [period] the Private Party shall deliver to the Institution in a form acceptable to the Institution:*

(1) *a report (the "**Unitary Payment Invoice Report**") which shall set out:*

(aa) *the Unitary Payment (if any) due in respect of the previous [period];*

(bb) *the aggregate Penalty Deductions (if any) due in respect of the previous [period];*

(cc) *any VAT due and payable in respect of any of the above amounts; and*

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230 This Clause will have to be amended in the event of an adjustment to the Unitary Payment to take into account reduced insurance premiums as a result of those risks that become Uninsurable and in respect of which Uninsurability relief is granted (see Part I:42 (*Insurance: Risks which Become Uninsurable*)).

231 To the extent that any interim Services are provided prior to the Service Commencement Date, this Clause must be modified appropriately.

232 The frequency of the Service Payments (for example, monthly, quarterly, etc.) will depend on the particular Project and the Institution's budgetary and administrative requirements for processing such payments. This must clearly be stipulated in the PPP Agreement.

233 The frequency at which the Unitary Payment will be made should be inserted. See footnote 231 above.

(dd) *the calculation of the applicable indexation factor*[234] *(if any); and*

(2) *a report (the "**Additional Payment Invoice Report**") which shall set out:*

(aa) *any other amount due and payable from either Party to the other under this PPP Agreement;*

(bb) *any VAT payable in respect of any of the above amounts; and*

(cc) *the calculation of the applicable indexation factor (if any).*

(iii) *The Unitary Payment Invoice Report delivered pursuant to Clause (c) shall be accompanied by a performance period report for the relevant [period] (prepared by the Private Party) which details the performance for the relevant [period] and clearly shows the basis of calculation of each of the amounts referred to in the Unitary Payment Invoice Report.*

(iv) *The Unitary Payment Invoice Report and the Additional Payment Invoice Report shall be accompanied by invoices from the Private Party to the Institution in respect of any amounts that are due and payable as contemplated in Clause (c) (Invoicing and Payment Arrangements). ("**Unitary Payment Invoice**" and "**Additional Payment Invoice**").*

(v) *If the Unitary Payment Invoice Report and the Additional Payment Invoice Report show a net amount owing by the Private Party to the Institution, then the Institution shall issue an invoice to the Private Party in respect of such amount promptly following its receipt of such Unitary Payment Invoice Report and the Additional Payment Invoice Report and the Private Party shall pay to the Institution the amount shown by such invoice not later than the [x]th Business Day after the Private Party has received such invoice.*

(vi) *Within [x] Business Days of the end of the Project Term, the Private Party shall render an invoice for the Unitary Payment and additional payments due in respect of the period (or part thereof) from the last invoice up to and including the last day of the Project Term.*

(vii) *If the Institution does not dispute the Unitary Payment Invoice Report or the Additional Payment Invoice Report,*

[234] See Section 37.2.5.

then it shall pay the amount specified in the relevant invoice on or before the Payment Date (as defined below).

(viii) *The "Payment Date" for any invoiced amount in a Unitary Payment Invoice or an Additional Payment Invoice shall be the [x]th Business Day after the date on which the relevant report and invoice are presented to the Institution.*

(d) *Manner of Payment*

All payments under this PPP Agreement shall be made in Rands by [insert method] to the recipient at [if by transfer of funds to a bank account, then that bank account must be located in the Republic of South Africa], quoting the invoice number against which payment is made.

(e) *Disputes*

If either Party disputes all or any part of the Unitary Payment or any additional amounts calculated in accordance with Clause (c), the undisputed amount of the Unitary Payment or any additional amounts shall be paid by the Institution in accordance with Clause (c) and the provisions of this Clause shall apply. The Parties shall use all reasonable endeavours to resolve the dispute in question within [x] Business Days of the dispute arising. If they fail so to resolve it, either Party may refer the dispute for resolution in accordance with the dispute resolution procedure in Clause [x] of this PPP Agreement. Following resolution of the dispute, the Private Party shall withdraw the original invoice/s and issue a replacement invoice/s to the Institution reflecting such agreed or determined amount. Such amount shall be paid by the Institution to the Private Party, together with interest on such amount calculated in accordance with Clause (f) (Late Payments) forthwith after receipt by it of the replacement invoice/s.

(f) *Late Payments*

Each Party shall be entitled, without prejudice to any other right or remedy, to receive interest on any payment not duly made pursuant to the terms of this PPP Agreement on the due date calculated from day to day at a rate per annum equal to the Default Interest Rate from the day after the date on which payment was due up to and including the date of payment.

(g) *VAT*

All invoices submitted by the Private Party to the Institution as contemplated in this Clause [x] (Payment) shall comply with the Value-Added Tax Act, 1991.

37.5 **Set-Off**

37.5.1 The Institution should ensure that the PPP Agreement contains an express right for the Institution to deduct Penalty Deductions from the Unitary

Payment. In respect of any other amounts owed to the Institution by the Private Party under the PPP Agreement during the Project Term there should, generally, be no right of set-off.

37.5.2 An exception is that the Institution should also be entitled to set-off any amounts that are required close to the expiry of the Project Term in order to reinstate the Project Assets to the state they ought to have been in, against amounts due to the Private Party.

37.5.3 Another exception is in the case of termination, where the Institution should generally have the right to set-off amounts due to it by the Private Party against the termination compensation payment due to the Private Party. The issue of set-off on termination is however dealt with more extensively in Part N:63 (*Termination: Compensation on Termination*).

37.6 Security for Institution Payments

The required approach is that no security (whether over Institution Assets or in the form of a guarantee or suretyship) should be given by any Institution or any other organ of state in respect of any payment obligations (whether for Unitary Payments, indemnified claims, termination compensation or other amounts) of that Institution under a PPP Agreement.

38 REPORTING REQUIREMENTS

38.1 The Treasury Regulations[235] require that PPP Agreements be managed and that mechanisms and procedures be established for monitoring and regulating the implementation and performance of PPP Agreements, liaising with the Private Party, resolving disputes with the Private Party and monitoring the day-to-day management of PPP Agreements.[236] The Treasury Regulations further provide that the Institution must appoint a Project Officer whose main purpose is to manage the Project on behalf of the Institution.[237]

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[235] Treasury Regulation 16.7.

[236] This does not limit the generality of Part P:75 (*Information and Audit Access*).

[237] The PPP Agreement should refer to the position rather than a named person.

38.2 An integral part of managing the Project is managing the risks associated with the Project by ensuring that the Project is implemented in accordance with the terms of the PPP Agreement. As the Private Party is responsible for the Project, the Institution will not be involved in the day-to-day running of the Project.

38.3 It is, however, crucial that the Institution is at all relevant times aware of the development and progress of the Project. The most efficient way of ensuring that this is done under the circumstances is by requiring the Private Party to liaise with the Institution on a regular basis. Such liaison should include the appointment by each Party of a liaison officer (in the case of the Institution this person should be the Project Officer) who would be the primary initial source of contact between the Parties. It should also include regular liaison meetings and reporting obligations whereby the Private Party provides the Institution with regular reports covering the various performance areas included in the Services. These reporting requirements should not limit the generality of the reporting requirements referred to in Part P:75 (*Information and Audit Access*) which are intended to cover reporting to the Institution in order to enable the Institution to comply with its disclosure and other auditing requirements imposed by law. The reporting referred to in this Section should cover the construction and development phase issues relating to progress of the Works, notice of any anticipated delays, the programme for managing any delays, and other issues of importance during the development phase.[238]

38.4 During the Service Period, the reporting requirements should cover the Private Party's availability and performance failures in relation to the output specifications of the Project.

38.5 The reporting obligations are essential in order to ensure that the Project risks are managed in accordance with the provisions of the PPP Agreement. The consideration of appropriate risk transfer also requires that the Institution ensures that the Private Party, if a company, complies with its obligations in

[238] The nature and type of reports required will depend on the specific Project.

terms of the Companies Act and that the Private Party does not take any action or omit to take any action that may adversely affect the legal status and financial stability of the Private Party.

38.6 The PPP Agreement must contain detailed provisions relating to the reporting and disclosure obligations of the Private Party. These obligations must mirror the Institution's disclosure obligations to the Accountant-General[239] as well as the Auditor-General.[240]

[239] See Module 8: Accounting Treatment for PPPs.

[240] See Module 7: Auditing PPPs.

PART I: INSURANCE

39 INTRODUCTION

39.1 In traditional "input"-based procurement, government self-insures against those risks retained by it which are not passed on to the private sector. Since, in PPPs, there is substantial risk transfer to the private sector, self-insurance by government is not practical or appropriate. Instead, the insurances required in a PPP will be maintained by the Private Party in order to mitigate the risks transferred to it. Since the Institution's primary concern in a PPP is that the Services remain available, it will need to be satisfied that the insurances maintained by the Private Party provide sufficient cover to enable the Private Party to meet its availability obligations.

39.2 As the Lenders take some performance risk in a project financed PPP, they too will usually have extensive insurance requirements. The Institution should not, however, rely on the Lenders' insurance requirements as an indication of the adequacy of the Private Party's proposed insurances for the Project. Since the insurances required for the Project are generally for the benefit of both Parties and the costs of such insurances are generally passed through to the Institution (in the Unitary Payment), the Institution will need to satisfy itself as to the adequacy and affordability of the insurances. Further, the Institution's insurance requirements will extend to the full Project Term, whereas the Lenders' insurance requirements will only extend to the term of the Debt, which is shorter.

39.3 It is essential for the Institution to seek its own insurance advice on the insurance requirements of the Project. This should be done at the feasibility study phase, the bid evaluation phase and the negotiation phase with the successful bidder. In this regard, the Institution should bear in mind that not all risks that the Institution wishes to transfer to the Private Party may be insurable. Accordingly, if the Private Party assumes an uninsurable risk it will charge a premium for doing so and this will be reflected in a higher Unitary Payment.

39.4 The Institution's insurance advice should focus on whether the risks transferred to the Private Party are insurable on commercially reasonable terms and, to the extent that commercially reasonable insurance cover is not available to cover any such risk, whether the premium that the Private Party will charge for assuming such risk will result in better value for money for the Institution or whether better value for money will be obtained if the Institution assumes and therefore "self-insures" such risk.[241]

39.5 The main issues dealt with in this Part I: (*Insurance*) are:

39.5.1 whether the Private Party should obtain and maintain certain insurances as a means of managing particular risks;

39.5.2 how substantial increases in insurance premiums over the Project Term that are not covered by the escalation in the Unitary Payments permitted under the inflation indexation mechanism in the PPP Agreement should be dealt with;

39.5.3 what should happen if any risks that are insurable at the commencement of the Project Term later become uninsurable;

39.5.4 the control of the defence of any litigation relating to an insured event; and

39.5.5 how the proceeds of the insurances should be applied.

40 INSURANCE REQUIREMENTS

40.1 General

40.1.1 The insurance requirements for a Project should reflect, having regard to the particular circumstances of the Project, the degree of risk transfer to the Private Party, the availability of insurances on commercially reasonable terms to cover any risk (relative to the probability of the

[241] In the bid evaluation and negotiation phases of a Project, the insurance advice will also focus on whether the insurance policies for the insurances proposed to be procured by the bidders are market-related or whether they contain unusual exclusions or endorsements.

occurrence, and the likely impact, of such risk) and value for money considerations. Although there are standard insurances that are typically available during the construction and/or operations phases of any Project, nevertheless the scope of these insurances (the risks, the exclusions, the endorsements, the amounts of cover and the deductibles) will vary from project to project and sector to sector.[242] The Institution and its insurance advisors must focus on all these factors when assessing the insurance requirements of the Project.

40.1.2 In order to optimise risk transfer, the Institution should allow the Private Party to manage its insurance arrangements as far as possible. In general terms, the Private Party will be expected to insure in accordance with Good Industry Practice.[243]

40.1.3 There will be a number of insurances, however, which the Institution will want to know are being taken out and maintained by the Private Party, to ensure that the Project will "survive" if certain risks materialise. These insurances should include:

40.1.3.1 material damage insurances, business interruption insurances (also referred to as "project delay" insurance in the construction phase of the Project) and fidelity insurance, each for both the construction phase and operations phase of the Project; and

40.1.3.2 the following legal liability insurances: third party liability insurance, employer's liability insurance, professional indemnity insurance and motor third party liability insurance. Save for the professional indemnity insurance, each of these legal liability insurances should be obtained for both the construction phase and operations phase of the Project. The professional indemnity insurance is a dedicated once-off policy that is only available for a

[242] Salient information (being the risks covered, all material exclusions, any endorsements, the amounts covered and all deductibles) on the Project Insurances should be included in a Schedule to the PPP Agreement. This information should be confirmed in writing by a letter(s) of undertaking from the broker appointed to place the Project Insurances.

[243] What constitutes Good Industry Practice for the purpose of the insurances should be part of the advice sought by the Institution from its own insurance advisor.

fixed period (typically, five years) from the commencement of the construction phase.

40.1.4 Generally, the Institution should ensure that the insurances taken out for the Project and paid for through the Unitary Payment do not include any insurance that will not directly benefit the Project. An example of such insurance is directors and officers liability insurance, as the risks associated with the negligent conduct of the directors and officers of the Private Party should be for the Private Party and should not be subsidised by the Institution through the Unitary Payment.

40.1.5 Professional indemnity insurance covers the risk of professional negligence resulting in design or engineering defects in the Works. Although this risk is a Private Party risk, the Institution should nevertheless ensure that this insurance is maintained by the Private Party because it will put the Private Party in funds to pay for the rectification of such defects and thereby help to ensure the continued delivery of the Services.

40.1.6 Business interruption insurance is necessary to ensure that the Private Party is able to service its Debt obligations and cover its capital and operating expenditure over periods when the Project Deliverables are not being performed (for example, during a Relief Event). This insurance is necessary, therefore, to ensure that the Project is not terminated because of a default under the Financing Agreements. However, the business interruption insurance may also extend to the Shareholders' return on Equity and/or the Shareholder Loans. To the extent that this insurance will compensate for the Shareholders' return on Equity or the repayment of the Shareholder Loans (including interest thereon), the cost of this insurance should not be passed through to the Institution through the Unitary Payment.

40.1.7 The Institution should be a co-insured for its own interests (where it has an insurable interest)[244] and require that its interests be noted on the policies relating to Project Insurances. The Institution should be aware that the Lenders too would want to be named as co-insureds under the policies for the Project Insurances.

40.1.8 The Institution should consider the value for money benefits of requiring the Private Party to take out non-vitiation protection, if available, in respect of certain Project Insurances (for example, the material damage insurances). Non-vitiation protection allows the Institution to claim as a co-insured under a policy even if the insurer would have been able to avoid a claim made by the Private Party on the basis that the Private Party withheld material information from the insurer (for example, the Private Party does not inform the insurer that it is intending to use highly flammable substances).[245] The Institution should obtain specific advice from its own insurance advisor as to what (if any) non-vitiation protection is available.

Standard Clause

Insurance

(a) *The Private Party shall take out and shall thereafter maintain the insurances listed in Schedule [x] and any other insurances in respect of the Project as may be required by law (the "**Project Insurances**"). Each of the Project Insurances listed in Schedule [x] must be taken out and become fully effective not later than the corresponding date set forth in Schedule [x][246]. Each of the Project Insurances (if any) not listed in Schedule [x] must be taken out and become fully effective not later than the earliest date required by law.*

(b) *The payment of the insurance premiums due and payable under the policy applying to any Project Insurance shall be the responsibility of the Private Party.*

[244] The Institution will have insurable interests in relation to most of the insurances. Possible exceptions here are the fidelity insurances, the employers' liability insurances and the motor third party liability insurances. This should be confirmed with the broker appointed to place the insurances for the Project.

[245] Where an insurance claim is vitiated because of the Private Party's non-disclosure of material information, the Private Party will be obliged to self-fund the loss not covered as a result of the vitiation. Its failure or inability to do so and to reinstate the Project may, depending on the materiality of the damage, be a breach of a material term and expose the Private Party to the risk of termination for Private Party Default.

[246] This date should be the earliest date by when the relevant risk is likely to arise.

(c) *No Party to this PPP Agreement shall take any action or fail to take any action, or (in so far as is reasonably within its power) permit anything to occur in relation to it, which would entitle any insurer to refuse to pay any claim under the policy applying to any Project Insurance.*

(d) *The Private Party undertakes that each Project Insurance shall:*

(i) *without limiting the provisions of Clause (e) below, name the Private Party as the insured;*

(ii) *provide for non-vitiation protection in respect of any claim made by the Institution as co-insured. If non-vitiation protection is unavailable when any such insurance policy is first placed, then the Private Party shall procure that the [Insurance Broker] investigates whether any non-vitiation protection subsequently becomes available prior to each renewal of the policy and provides written confirmation promptly upon the renewal thereof as to the unavailability thereof to the Institution. If any non-vitiation protection subsequently becomes available, then the Institution shall be entitled to require the Private Party to procure such protection and the costs thereof shall be borne by the Private Party;*[247]

(iii) *contain a clause waiving the insurers' subrogation rights against the Institution, its employees and agents;*[248]

(iv) *provide for [x] days' prior written notice of its cancellation, non-renewal or amendment to be given to the Institution;*

(v) *contain a clause recording that such Project Insurance is a primary insurance and shall not be brought into contribution by any other insurances; and*

(vi) *provide for payment of any proceeds under any of the material damage insurances included in the Project Insurances to be made by the insurers in accordance with Clause [x] (Reinstatement).*

(e) *The Private Party shall procure that each of the Project Insurances shall name the Institution as a co-insured for its separate interest.*[249]

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[247] See Section 40.1.8.

[248] This waiver will only be granted in favour of a co-insured and is one of the benefits of being a co-insured. If the Institution cannot be a co-insured under any insurance policy (because it has no insurable interest in such insurance), then appropriate amendments should be made to this provision.

[249] This will only be possible in relation to policies in respect of which the Institution has an insurable interest. If the Institution cannot be a co-insured under any insurance policy (because it has no insurable interest), then appropriate amendments should be made to this provision.

(f) *The Private Party shall furnish the Institution, on request, with:*

(i) *true and complete copies of the policies of all the Project Insurances (together with any other information reasonably requested by the Institution relating to such policies) and the Institution shall be entitled to inspect them during ordinary business hours; and*

(ii) *satisfactory evidence that the premiums due and payable under any such policies have been paid and that the Project Insurances are in full force and effect in accordance with the requirements of this Clause.*

(g) *The Private Party shall, as and when required pursuant to the terms of the relevant policy,[250] renew each Project Insurance for so long as any risk covered thereby exists and shall furnish the Institution with true and complete copies of each certificate of renewal for such Project Insurance as soon as possible but in any event no less than at least 10 (ten) days before the relevant renewal date.*

(h) *If the Private Party breaches Clause (a) or (b) above in relation to any Project Insurance, the Institution may pay any premiums required to keep such Project Insurance in force and effect, or itself procure such Project Insurance[251] and may recover all premiums or other costs incurred by it in doing so from the Private Party on written demand.*

(i) *The Private Party shall notify the Institution within [x] days after submitting any claim in excess of R[x] (indexed to [CPIX]) under any of the insurance policies referred to in this Clause, accompanied by full details of the event giving rise to the claim.[252]*

(j) *Neither the failure to comply nor full compliance with the insurance provisions of this PPP Agreement shall limit or relieve the Private Party of its liabilities and obligations under this PPP Agreement.*

40.2 **Variations**

If the Institution wishes to change the limits or scope of the Project Insurances during the Project Term, then this should be treated as an Institution Variation (see Part K: 50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)).

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[250] Professional indemnity insurance is available for a fixed period (typically five years) and is generally not renewable annually.

[251] This will not be possible for insurances in respect of which the Institution has no insurable interest.

[252] In projects where many claims are likely, the Institution can agree upon a minimum amount below which the Institution is not notified. If this is done, it may be necessary for the Institution to be notified of important claims (for example, accident and injury based claims).

40.3 Inflationary Increases in Insured Amounts

40.3.1 There must be a mechanism to ensure that the insured amounts increase over the full Project Term in order to keep pace with inflation.[253] This is commonly done through the inflation indexation mechanism.

40.3.2 Index-linking can cause a problem for the legal liability insurances if such insurances cannot be bought in odd amounts although this is normally dealt with by rounding up annually to the nearest whole insurable amount.

40.4 Insurers

40.4.1 The placing of insurance is subject to the Short-Term Insurance Act, 1998, which requires that all short-term insurance be placed with insurers registered in terms of that Act (being only South African companies) or Lloyd's.

40.4.2 The PPP Agreement should require that the Private Party place all the Project Insurances with permitted insurers in accordance with applicable law.

40.4.3 That Act also limits access to the worldwide insurance market if insurance is available in South Africa. In other words, any insurance must be placed in South Africa first if it is available here and resort may only be had to the worldwide insurance market if the insurance is not available here.

40.5 Changes in Terms of Insurance Policies

40.5.1 The Institution should ensure that the insurers are under an obligation to inform the Institution of changes in the policies in respect of the Project Insurances. This obligation should be confirmed in writing by the insurance broker appointed to place the Project Insurances.

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[253] This will not be necessary where the insured amount is an unspecified amount (for example, the reinstatement cost of fixed assets or the market value of movables) rather than a specific sum (as is usually the case for legal liability insurance).

40.5.2 Some insurers may not agree to this. Accordingly, the Institution should also ensure that the PPP Agreement obliges the Private Party to notify the Institution of any such changes and that the insurance broker gives a similar undertaking.

41 INCREASES IN INSURANCE RATES

41.1 The risk of substantial increases in the rates at which the premiums for the Project Insurances are calculated (not covered by the escalation in the Unitary Payment permitted under the inflation indexation mechanism in the PPP Agreement) should generally be borne by the Private Party. The Institution should ensure that such risk is not passed through to the Institution.

41.2 The only exceptions here are increases resulting from Institution Variations. This risk should be borne by the Institution and taken into account in the price variation provisions. Increases resulting from Variations by the Private Party must be borne by it.

42 RISKS WHICH BECOME UNINSURABLE

42.1 General

42.1.1 The PPP Agreement must address the situation where a risk to be covered by any of the Project Insurances and which was insurable as at the Signature Date subsequently becomes "uninsurable". In this Standardisation "Uninsurability" is defined with reference to the availability of insurance for a particular risk and not the availability of insurance upon particular terms or with particular levels of deductibles.

Standard Definition

*"**Uninsurable**" means, in relation to a risk, either that:*

(a) insurance is no longer available from reputable insurers in the worldwide insurance market; or

(b) even if insurance is available from reputable insurers in the worldwide insurance market, the insurance premium payable for insuring that risk has increased to such a level that the risk is no longer being insured against in the South African insurance market.

42.1.2 The consequences of the Uninsurability of any risk (ranging from Private Party Default to the grant of Uninsurability relief, which entails the partial assumption by the Institution of the now Uninsurable risk) will depend on:

42.1.2.1 the type of risk;

42.1.2.2 who is responsible for the Uninsurability of that risk; and

42.1.2.3 whether other service providers carrying on similar businesses to the Private Party would cease to carry on business as a result of the Uninsurability of that risk.

42.1.3 Institutions should be aware that the Uninsurability of a risk should not in and of itself be treated as a Private Party Default. If, however, the Private Party has *caused* the risk to become Uninsurable, then this will give rise to a termination right for Private Party Default.

42.2 Types of Risk for which No Uninsurability Relief is Granted

42.2.1 Uninsurability relief may not be extended to all risks covered (or which ought to have been covered) by the Project Insurances.

42.2.2 No such relief may be granted in respect of those risks covered (or which ought to have been covered) by any fidelity insurance, professional indemnity insurance or non-vitiation insurance included in the Project Insurances. The reason for this is that the grant of such relief will undermine the transfer of these risks to the Private Party. If the Institution were to grant such relief in relation to these risks, the Institution might then be insuring the Private Party against claims relating to the Private Party's (or its Subcontractors') own negligence.

42.2.3 Whether such relief should be granted in respect of those risks covered (or which ought to be covered) by any business interruption insurance should be determined on a project-by-project basis. In the absence of Uninsurability relief for the risks to be covered by the business interruption insurances, the Lenders may require the Private Party (or its

Shareholders) to set aside substantial contingency provisions to cover defaults in debt service. This may result in substantially higher bid prices. It may also impact negatively on value for money. If better value for money will be achieved by the grant of Uninsurability relief in relation to such insurance, then the Institution should consider granting such relief. However, such relief must *only* extend to that portion of the business interruption insurance that covers debt service and the Private Party's capital and operating expenditure.

42.3 **Other Preconditions for Uninsurability Relief**

42.3.1 No Uninsurability relief should be granted in respect of any risk if the Private Party has *caused* the relevant risk to become Uninsurable. This should give rise to a termination right on the part of the Institution for Private Party Default.

42.3.2 No Uninsurability relief should be granted in respect of any risk if other service providers carrying on business similar to the Project would not cease to do so as a result of the Uninsurability of such risk.

42.4 **Uninsurability Relief**

42.4.1 If a risk (other than the risks contemplated in Section 42.2) becomes Uninsurable and the preconditions for Uninsurability relief are satisfied, then the Parties should endeavour to agree alternative means by which that risk can be managed. If, however, no such agreement is reached, the PPP Agreement will continue in force but the risk will revert to the Institution. The Unitary Payment must then be reduced by an amount equal to the premiums payable in respect of such risk.

42.4.2 Should the now-uninsured risk then occur, the Institution can choose either to:

42.4.2.1 pay an amount equal to the insurance proceeds that would have been payable had the risk continued to be insurable, in which event the PPP Agreement will continue in force; or

42.4.2.2 terminate the PPP Agreement as if for Force Majeure, and pay to the Private Party compensation equivalent to the amount payable to it on Force Majeure termination.

***Standard Clause*[254]**

Uninsurable Risks

(a) If a risk usually covered by the Project Insurances in Schedule [x],[255] becomes Uninsurable, then the Private Party shall notify the Institution within [x] days of the risk becoming Uninsurable.

(b) If both Parties agree, or it is determined in accordance with Clause [x] (Fast-track Dispute Resolution), that:

(i) the risk is Uninsurable;

(ii) the risk being Uninsurable is not caused by the actions or omissions of the Private Party or a Subcontractor; and

(iii) other service providers carrying on businesses similar to the Project would cease to do so as a result of such Uninsurability,

then the Parties shall meet to discuss the means by which the risk should be managed (including by way of self-insurance by either Party).

(c) The Private Party shall bear the onus of proving the circumstances in Clause (b)(i) to (iii).

(d) If the requirements of Clauses (a) and (b) are met:

(i) this PPP Agreement shall continue in force and effect;

(ii) the Unitary Payment shall be reduced by an amount equal to the premium previously payable in respect of the Uninsurable risk; and

(iii) on the occurrence of the risk (but only if that risk has continued to be Uninsurable) the Institution shall, at the Institution's option, either pay:

(aa) to the Private Party an amount equal to the insurance proceeds that would have been

[254] See footnote 258.

[255] This Schedule should refer to all the Project Insurances specifically identified by the Parties in the Schedule referred to in Standard Clause (a) in Section 40.1 (*Insurance Requirements*) except those Project Insurances referred to in Section 42.2 (*Types of Risk for which No Uninsurability Relief is Granted*).

payable[256] *had the risk continued to be insurable, in which event this PPP Agreement will continue; or*

(bb) *an amount equal to the amount set out in Clause [x] (Compensation on Termination for Force Majeure) and this PPP Agreement will terminate as if for Force Majeure.*[257]

42.5 **Uninsurability Relief in respect of Third Party Claims**

42.5.1 The Private Party may be concerned in relation to Uninsurable third party claims, that in the standard approach described in Section 42.4 above a substantial amount of time may pass between the time when Uninsurability has been established and the time when the Institution makes its election (which will only be when the Uninsurable event actually occurs), and that for this entire period its directors and officers will not know whether the PPP Agreement will be terminated for Force Majeure or whether the Uninsurable third party claims will be paid out by the Institution.

42.5.2 In projects where there is a high risk of substantial third party claims, the bidders may take the view that this approach will expose their directors and officers to claims of poor corporate governance or even reckless conduct, that is, the reputations of directors and officers may be impugned in so far as they are "seen" to be managing a business which has no third party insurance in place.

42.5.3 In such projects, the Institution should consider whether better value for money will be achieved if its election (to terminate the PPP Agreement or pay out the third party claims) is made at the time when the Uninsurability of the third party claims is established. At this point, the PPP Agreement will terminate for Force Majeure, unless the Institution then agrees that it will pay out future third party claims in which event the PPP Agreement continues. In this way, the Private Party's directors

[256] The Institution should therefore deduct all deductibles that could have been made had the insurance continued to be in place.

[257] See Part N:66 (*Termination: Compensation on Termination for Force Majeure*).

and officers will have the comfort of knowing (where the PPP Agreement continues) that the Uninsurable risk will be borne by the Institution.

42.5.4 If the above approach is taken, it is critical that the Institution retains the option to terminate the PPP Agreement in the future (as if for Force Majeure) if, at any time after an Uninsurable third party claim is made, the Institution comes to the conclusion that the continuation of the PPP Agreement is untenable.

42.5.5 If the Institution does decide to "delay" its decision to terminate the PPP Agreement until after the first or even later occurrences of the Uninsurable risk, then the Institution will have to pay out the full Force Majeure termination compensation even though it may already have paid out substantial third party claims, so such a delay might not prove to be cost-effective. This should be borne in mind by the Institution at the time when the election has to be made.[258]

43 CONTROL OF THE DEFENCE IN LITIGATION ON AN INSURED EVENT

43.1 The Institution may wish to control the defence of any litigation against the Private Party that is likely to have implications for the Institution itself or wider government. If the Institution is likely to become a co-defendant in the relevant litigation or a defendant in a number of similar litigation proceedings based on the precedent in law set by the relevant litigation, it is likely to want to control the litigation from an early stage. This may involve prolonging litigation in order to establish a clear precedent instead of settling out of court. Alternatively, the Institution may wish to settle the litigation as soon as possible for public policy reasons and, in such cases, these will override commercial considerations (this may be the case, for example, in prison and hospital projects).

43.2 Insurers in the South African insurance market will, however, usually expect to be in control of any litigation which may lead to a claim under one of their

[258] The Standard Clause above will have to be appropriately amended if the approach in this Section 42.5 is adopted.

policies. They will be reluctant to pay out for claims where they have no control of the defence. The degree of control required by the Institution should be examined on a project-specific basis and advice in this regard should be sought by the Institution from its insurance advisor.

43.3 Generally, the Institution should expect to assume some liability for litigation costs if it wishes to insist on controlling such litigation. In practice, it is extremely difficult to determine what such liability should be. In principle, the Institution should be liable for any difference between what the insurer would have paid and the final amount settled or decided. It would be very hard to establish, however, what amount would have been an acceptable settlement to all parties (including the plaintiff). In practice, the Institution may find that it is obliged to take on the majority, or even all, of the relevant litigation costs in return for the right to control the defence.

44 APPLICATION OF INSURANCE PROCEEDS

44.1 Material Damage Insurance

44.1.1 Reinstatement

44.1.1.1 Material damage insurance policies typically allow for exact reinstatement of the assets following an insured event.

44.1.1.2 Where the insurance proceeds fall short of the full cost of reinstatement and this shortfall is due to under-insurance by the Private Party, this shortfall must be funded by the Private Party.[259]

44.1.1.3 The Institution may, however, decide to change the Services following an insured event and this may entail something other than exact reinstatement, which may cost more than exact reinstatement. Where the insurance proceeds do not cover the full cost of "reinstatement" and the additional cost is due to an

[259] Institutions should nevertheless confirm in advance with the insurance broker appointed to place the Project Insurances whether the material damage insurances will cover the full reinstatement costs. This confirmation should be obtained in writing and included in the broker's letter of undertaking.

Institution Variation, then the extra cost must be funded by the Institution in accordance with the variation in Services mechanism (see Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)). Although the material damage insurances should at least always provide for exact reinstatement, the Private Party should nevertheless be required to negotiate these insurances on terms that permit something other than exact reinstatement if the Institution elects to change the Services.[260]

44.1.1.4 The PPP Agreement must oblige the Private Party to prepare and deliver a reinstatement plan setting out the scope of works that the Private Party will need to undertake to reinstate the Project Assets, the timeline for such works and details of the subcontractor who will undertake those works (if this person is not the Construction Subcontractor). In practice, however, following the occurrence of an insured event the Parties will sit down and negotiate whether and, if so, how to reinstate the Project Assets. Accordingly, the PPP Agreement should also set out provisions governing the process the Parties will follow when negotiating the reinstatement of the Project Assets. The Institution should ensure that the PPP Agreement clearly sets out what should happen in the event of any disputes over any reinstatement plan. The Institution should also ensure that all material damage insurance proceeds are utilised in accordance with the agreed reinstatement plan.

44.1.1.5 Even if the insured event is one which would normally entitle the Institution to terminate the PPP Agreement, the Institution's termination right should be suspended if a reinstatement plan has been adopted and the reinstatement works are being properly carried out in accordance with that plan. If the Private Party does

[260] If the Institution decides to reinstate with a lower Services level, then the Unitary Payment should remain the same unless compensation is paid to the Private Party. The Institution should also be aware of the fact that a decision not to reinstate fully may impact upon the amount of insurance proceeds recoverable.

not comply with the reinstatement plan, then the suspension of the Institution's rights of termination should be lifted.

44.1.1.6 The Institution must ensure that upon termination of the PPP Agreement for whatever reason, the Institution receives the benefit of any such insurance proceeds so that it can proceed with or continue the reinstatement of the Project Assets.[261] In many instances, the Private Party will be forced to replace or reinstate prior to the settlement of the insurance claim. It may therefore be prudent to stipulate that the proceeds of the insurance shall be applied for the benefit of the Project if no longer directly applicable to the insured event in terms of the reinstatement plan.

Standard Clause

<u>Reinstatement</u>

*(a) [Subject to Clause [x] (Economic Test)],[262] all insurance proceeds received under any policy referred to in Part [x] of Schedule [x] ("**Material Damage Policies**") shall be applied to repair, reinstate or replace each part or parts of the Project Assets in respect of which the proceeds were received.[263]*

*(b) All insurance proceeds paid under any Material Damage Policy in respect of a single event or a series of related events shall be paid into a bank account to be opened in the name of both Parties (the "**Joint Insurance Account**").[264]*

(c) [Subject to Clause [x] (Economic Test)][265], where a claim is made or proceeds of insurance are received or are receivable under any Material Damage Policy in respect of a single event or a series of related events:

(i) the Private Party shall deliver as soon as practicable and in any event within [x] days after the making of the claim, a plan (the

[261] This is particularly important if the PPP Agreement is terminated for Private Party Default and the Institution elects (and is able) to retender the PPP Agreement.

[262] The application of this test will only be appropriate in certain projects. If this test is not appropriate then the bracketed phrase must be deleted. In this regard see Section 44.1.2.2.

[263] The Private Party will be liable to make good any deductibles in terms of such policies.

[264] This account must be excluded from the Lenders' security regime, although the Lenders (or their agent) may be co-insureds under these policies.

[265] See footnote 262.

*"**Reinstatement Plan**") prepared by the Private Party for the carrying out of the works necessary (the "**Reinstatement Works**") to repair, reinstate or replace the Project Assets which are the subject of the relevant claim or claims in accordance with Clause (d) below. The Reinstatement Plan shall set out:*

(aa) if not the Construction Subcontractor, then the identity of the person proposed to effect the Reinstatement Works, which shall be subject to the prior written agreement of the Institution; and

(bb) the proposed terms and timetable upon which the Reinstatement Works are to be effected (including the date that the Project will become fully operational), the final terms of which shall be subject to the prior written agreement of the Institution,

provided that if the Parties fail to reach any such agreement, then the dispute shall be referred for resolution by [the Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution); and

(ii) if the Institution is satisfied[266] *that the Reinstatement Plan (as amended by agreement with the Institution or in accordance with the decision of [the Independent Expert]) will enable the Private Party to comply with Clause (d) below within a reasonable timescale, then:*

(aa) the Reinstatement Plan shall be adopted;

(bb) the Private Party shall enter into contractual arrangements to effect the Reinstatement Works with the person agreed to by the Institution;

*(cc) prior to the earlier to occur of the Termination Date and the Expiry Date, any amount standing to the credit of the Joint Insurance Account together with any interest accrued (the "**Relevant Proceeds**") may be withdrawn by the Private Party to the extent required to enable it to make payments in accordance with the terms of the contractual arrangements referred to in*

[266] The Institution should be aware that following any material damage to the Project, the Private Party will only be permitted to claim under any business interruption insurance if the insurer is satisfied that the Private Party is using its reasonable endeavours to reinstate. Accordingly, the Institution's response to the proposed Reinstatement Plan should be reviewed by the Institution as a matter of priority and the Institution should respond to the Private Party within a reasonable period of time.

Clause (ii)(bb) above, and to meet any other reasonable costs and expenses of the Private Party for the sole purposes of funding the Reinstatement Works. Following the earlier to occur of the Termination Date and the Expiry Date, the Institution may withdraw the Relevant Proceeds for the purposes of funding any Reinstatement Works;

(dd) *the Institution agrees and undertakes that, subject to compliance by the Private Party with its obligations under this Clause, and provided that the Private Party procures that the Reinstatement Works are carried out and completed in accordance with the contractual arrangements referred to in Clause (bb) above, it shall not exercise any right which it might otherwise have had to terminate this PPP Agreement by virtue of the event which gave rise to the claim for the Relevant Proceeds; and*[267]

(ee) *after the Reinstatement Plan has been implemented to the reasonable satisfaction of the Institution and in accordance with Clause (d) below, the Institution shall permit the withdrawal by the Private Party of any Relevant Proceeds that have not been paid under Clause (cc) above.*

(d) *Where insurance proceeds are to be used in accordance with this PPP Agreement to repair, reinstate or replace any Project Asset forming part of the Works, the Private Party shall carry out the Reinstatement Works or procure that such works are carried out in accordance with the [construction specification] so that on completion of the Reinstatement Works, the provisions of this PPP Agreement are complied with.*

44.1.2 Economic Test

44.1.2.1 The Private Party should always be obliged to reinstate the damaged Project Assets if an insured event occurs.[268]

[267] If the insured event is a Relief Event, the Institution would not have any termination rights in respect of such event. However, the Institution would be entitled to terminate the PPP Agreement if the event is a Private Party Default. During a reinstatement period, however, that termination right should be suspended, but the provisions relating to Compensation Events, Relief Events and Variations should continue to apply.

[268] It is standard in the insurance industry for the insured amount in relation to fixed assets to cover their full replacement value as opposed to their market value.

44.1.2.2 In some projects, the Lenders will want to impose an "economic test" to determine whether reinstatement will enable them to recover the Debt in full. If the economic test shows that this is not possible, then the Lenders will prefer to appropriate the insurance proceeds to service the Debt instead of allowing the proceeds to be applied in reinstatement of the Project Assets. This allows the Lenders to exit from the Project, although the Private Party and its Shareholders will remain in the Project.

44.1.2.3 Resort to an "economic test" is, however, only appropriate where there is a high risk of total destruction of the Project Assets and a lengthy reinstatement period. The decision by an Institution to subject the reinstatement process to the Lenders' economic test should only be made if this will ensure better value for money.[269]

44.1.2.4 If an economic test is agreed to, it must be based on a loan life cover ratio[270] so that the Lenders cannot exit from the Project if the test shows that debt service is still achievable (even if there is hardly any cushion above the ratio) over the remaining period to the final maturity date of the Debt. The use of an annual debt service cover ratio as an economic test is inappropriate as this ratio contains only an annual "snapshot" of performance, which is not relevant.[271]

44.1.2.5 The economic test involves a comparison of the amount of the Debt with the amount of the future Project revenues forecast to be earned if the insurance proceeds are applied in reinstatement and the reinstatement is carried out. The length of the remaining

[269] In projects where there is a low risk of total destruction of the Project Assets (for example, where the Project Assets are spread across a wide area, as will be the case in a road project) there should be no resort to such a test.

[270] If this is being calculated during the Service Period and no further drawdowns are possible, then this is calculated by *dividing*: (a) forecast net revenues until the final maturity date of the Debt (including Unitary Payments and the proceeds of business interruption insurance), discounting back future revenues to the date of calculation (at the interest rate payable under the Debt) and assuming that the damaged Project Assets have been reinstated; by (b) the Debt outstanding less all credit balances, each as at the date of calculation. If further drawdowns can be made, then this calculation should take into account actual drawdowns plus all undrawn commitments to the extent forecast in the Financial Model.

[271] There should be no need to specify a threshold amount of insurance proceeds below which the economic test should not be applied because the test should, in any event, only be applied in cases of total or near total destruction.

Project Term and the time required to reinstate the Project Assets (during which time and depending on when in the Project Term the insured event has occurred and the extent of the damage, the Unitary Payments may not be made in full or at all) are critical factors in the application of this test. The object of the test is to establish whether the full Debt will be recoverable from the Project revenues.

44.1.2.6 If the economic test shows that the full Debt will be recoverable after the insurance proceeds are applied in reinstatement of the Project Assets, then the insurance proceeds must be so applied in accordance with the pre-agreed reinstatement plan.

44.1.2.7 If the economic test shows that the full Debt will not be recoverable as aforesaid, then the Lenders should be permitted to apply the insurance proceeds or an amount equal to the Debt (whichever is the lesser) towards prepayment of the Debt and the Private Party must remain under an obligation (to the Institution) to reinstate the Project Assets. If, as is likely, the Private Party is not financially able to do so, then it will be in breach of the PPP Agreement and the Institution may terminate for Private Party Default in the usual way. The Institution can then rebuild the asset through a new tender.

44.1.2.8 The Private Party's funders may propose that the utilisation of the insurance proceeds should depend on who caused the insured event, so that if the Institution caused the insured event then the insurance proceeds must be released for the benefit of the Lenders and, to the extent that these proceeds exceed the Debt, for the benefit of the Shareholders. In this scenario, the Project would probably go into default because the Private Party will lack the funds to reinstate the Project. However, this fault-based approach is inappropriate. The material damage insurances will have been paid for by the Institution (through the Unitary Payment) to reinstate the Project Assets following an insured event and thereby ensure the continued provision of the Services (effectively for the benefit of both Parties) regardless of the circumstances giving rise to the insured event. Accordingly, if the insurance proceeds are sufficient to reinstate the Project Assets and such reinstatement will not impact on debt service over the originally envisaged repayment period, then the Lenders and the Shareholders should not be allowed to exit. In any event, the Institution is itself not entitled to terminate the PPP Agreement (even if the insured event is a Private Party Default) where the Private Party reinstates the Project Assets.

44.1.2.9 The Private Party's funders may also propose that if the insurance proceeds are not sufficient to fully reinstate the Project Assets, then the PPP Agreement should permit the Private Party to raise further capital from its funders and to extend the Service Period to the extent necessary to repay such capital and any return thereon. This approach must not be adopted because under-insurance is a Private Party risk. In addition, the further capital injections will increase the Institution's termination compensation liability above that forecast in the base case Financial Model. Furthermore, Service Period extensions will create budgetary uncertainties and also allow the Shareholders to achieve a full return on the capital invested by them even where the insured event that triggered the extension is a Private Party Default.

***Standard Clause*[272]**

<u>*Economic Test*</u>

(a) If all or substantially all of the Project Assets are destroyed or substantially destroyed in a single event or a series of related events and the insurance proceeds (when taken together with any other funds available to the Private Party)[273] *are equal to or greater than the amount required to*

[272] This Standard Clause is only appropriate if there is a high risk of total destruction of the Project Assets.

[273] Such funds could, for example, include sums made available to the Private Party by the Institution to ensure that the test is passed and that, as a result, reinstatement occurs in accordance with Section 44.1.1 (*Reinstatement*).

repair, reinstate or replace the Project Assets, then the Private Party[274] *shall calculate*[275] *the [loan life cover ratio] in accordance with the Financing Agreements (on the assumption that the Project Assets are repaired or reinstated in accordance with this PPP Agreement).*

(b) *If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is greater than or equal to the [event of default level],*[276] *then the Private Party shall apply the insurance proceeds in accordance with the Reinstatement Plan set out in Clause [x] (Reinstatement).*

(c) *If the calculation referred to in Clause (a) above shows that the [loan life cover ratio] is less than the [event of default level], then an amount equal to the lesser of:*

(i) *the amount of the insurance proceeds; and*

(ii) *the amount of the Debt* ***less****, to the extent that it is a positive amount, the aggregate, as at the date of calculation, of:*

(aa) *all credit balances on any bank accounts held by or on behalf of the Private Party and the value of any right of the Private Party or the Lenders to receive insurance proceeds or any proceeds pursuant to letters of credit and of any such proceeds actually received by them (save where such credit balances or proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;*

(bb) *all amounts payable by the Lenders (or the counter-parties to the interest rate or exchange rate hedging arrangements provided for in the Financing Agreements) to the Private Party in connection with the early termination of such hedging arrangements as a result of prepayment of amounts outstanding under the Financing Agreements; and*

(cc) *the market value of any other assets and rights of the Private Party or the Lenders (other than those that are transferable to the Institution pursuant to this PPP Agreement) less liabilities*

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274 The Lenders will control the calculation in terms of the Financing Agreements. The Institution must review the Financing Agreements to establish how the loan life cover ratio is to be applied.

275 There will be a debate as to how this should be done. Since the Lenders' interests are being protected here, the formulae set out in the Lenders' financial model provided for in the Financing Agreements should be used.

276 That is the loan life cover ratio as provided in the Financing Agreements, below which an event of default will be triggered under the Financing Agreements entitling the Lenders to accelerate the Debt.

of the Private Party or the Lenders properly incurred in connection with this PPP Agreement; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(A) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in connection with the Private Party's obligations in relation to the Project; and

(B) agreements or arrangements entered into by the Private Party to the extent that such agreements or arrangements were not entered into in the ordinary course of business and on commercial arm's length terms,

shall be released from the Joint Insurance Account to the Private Party and shall be applied by the Private Party towards the prepayment of the Debt; provided, however, that such release shall not discharge the Private Party from performing the Project Deliverables in accordance with this PPP Agreement.[277]

44.2 **Other Project Insurance**

44.2.1 In the case of any legal liability insurance, the Private Party should be obliged to apply the proceeds of any claim made under such insurance either in satisfaction of the liability in respect of which such claim is made, or to reimburse the Private Party to the extent that the liability has already been paid by it out of other Project revenues.

44.2.2 The Private Party should be obliged to apply the proceeds of any business interruption insurance in payment of any capital and operating expenditure incurred by the Private Party in performing the Project Deliverables in the reinstatement period, and the balance in service of the Debt payments becoming due and payable in that period. The PPP Agreement should prohibit the Private Party from applying any such

[277] This will mean the amounts are released to the accounts secured to Lenders and the Lenders will apply such amounts as a prepayment against Debt.

proceeds in repayment or payment of Shareholder Loans or to cover any return on Equity.