PART J: RELIEF EVENTS, COMPENSATION EVENTS AND FORCE MAJEURE

45 INTRODUCTION

45.1 The Private Party usually undertakes to ensure Service Commencement by a particular fixed date[278] and to continue to provide the Services for the duration of the PPP Agreement. There may, however, be events which result in the Private Party, through no fault on its part or otherwise attributable to it, being unable to meet this obligation. In these circumstances, the Private Party should be excused from liability for failure to commence or provide the Services. A balance must, however, be attained between encouraging the Private Party to manage the risk and protecting the Institution from non-performance.

45.2 These events can be divided into three broad categories:

45.2.1 Relief Events: These are events which may arise at any stage during the Project Term which are best managed by the Private Party (although not necessarily in its control) and for which the Private Party bears the financial risk, but in respect of which neither liquidated damages nor rights of termination should arise (see Section 46 (*Relief Events*)).

45.2.2 Compensation Events: These are events that are clearly at the Institution's risk and in respect of which the Private Party should be compensated (see Section 47 (*Compensation Events*)).

45.2.3 Force Majeure Events: These are a limited set of events which may arise during the Project Term through no fault of either Party, which are best managed by the Private Party (although not in its control) and in respect of which rights of termination can arise (see Part N:66 (*Termination: Compensation on Termination for Force Majeure*)).

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[278] The typical structure in PPPs is to require the Private Party to ensure Service Commencement either by the scheduled date for the completion of construction or at any time from the Signature Date, but by the Long Stop Date (see Part E: (*Duration and Service Commencement*)).

45.3 The distinction between Relief Events and Compensation Events (at least during the construction phase) is sometimes expressed as being the difference between the Private Party being given "time" only and "time and money". Force Majeure is, however, a different category of event and is dealt with alongside other termination-related issues (see Part N:66 (*Termination: Compensation on Termination for Force Majeure*)).

45.4 Certain of these events may be dealt with differently depending on the nature of the Project, the likelihood of the event occurring and the value for money obtained if the Private Party prices into its bid the risk of such event occurring. Given that Compensation Events result in the Institution paying money to the Private Party, this should only be incorporated after careful consideration of the Institution's specific obligations in each project. For example, in a Project in which the Responsible Authority's use of the Project Site during the construction phase means that there is a high risk of delays occurring during the construction phase, the Institution may accept that these delays should be Compensation Events. In a Project where such risks do not exist, the Parties may agree that a Relief Event is the most appropriate way to deal with that risk. The risk of discovery of fossils or antiquities during the construction phase may result in a Relief Event to the extent that they could not have been discovered by the Private Party through the exercise of reasonable due diligence (as is suggested in Part D:15 (*Project Site: Heritage Resources*)).

45.5 Similarly, the risk of planning delays may result in a Relief Event to the extent that such delays are not due to any fault or failure on the part the Private Party. As far as the discovery of adverse ground conditions and historic contamination is concerned, this should not usually be at the Institution's risk as the Private Party should have carried out appropriate surveys in relation to such matters prior to signing the PPP Agreement and can often assess and accept such risks more economically than the Institution is able to do. The situation may be different in specific circumstances such as where the Private Party has been prevented from carrying out appropriate surveys or it is not affordable or good value for money for surveys to be undertaken (for example, because of the number of sites involved in the Project).[279]

46 RELIEF EVENTS

46.1 Purpose and Scope

46.1.1 Relief Events are events which prevent performance by the Private Party of its obligations at any time, in respect of which the Private Party bears the financial risk in terms of increased costs and reduced revenue but for which it is given relief from termination for failure to provide the full Services and relief from liquidated damages for late Service Commencement, if any. The events listed in the standard definition below may be outside the Private Party's control, but that is not the only appropriate measure of whether an event should appear on the list since many events beyond the Private Party's control at the time they occur may in fact have been prevented by proper precautions (for example, fire). Relief Events should cover those events, the risk of which is better borne by the Private Party as it is in a better position than the Institution to mitigate and manage the consequences. This mitigation and management could be in the form of insurance, a combination of insurance and proper planning, or by risk management and planning (that is, the events can be worked around while they exist).

46.1.2 Termination should not follow a Relief Event. This is because any replacement Private Party would be similarly affected and so the Institution's position would not be improved by termination. Relief Events do not, however, require the same treatment as Force Majeure events (see Part N:66 (*Termination: Compensation on Termination for Force Majeure*)) as their consequences are not likely to be as severe and will usually only last for a finite period.

[279] See Part C: (*General Obligations)* and Part D: (*Project Site*).

46.1.3 It may be argued that a right to terminate should exist if a Relief Event continues for a prolonged period. Other than in certain critical projects[280] or in the case of the discovery of any unforeseen heritage object[281] this is not recommended for two reasons. First, because this may not sufficiently incentivise the Private Party to manage the risk (depending on any compensation payable on termination) and second, because the occurrence of such an event is likely to be of a limited duration (for example, strikes by a supplier) and/or lead to an alternative sourcing of the supply concerned by the Private Party (for example, any shortage of fuel).

Standard Definition

"***Relief Event***" *means*:[282]

(a) any fire, explosion, tempest, flood, ionising radiation (to the extent it does not constitute an event of Force Majeure), earthquakes, riot and civil commotion, or pressure waves caused by devices travelling at supersonic speed;

(b) (without limiting the obligations of the Private Party regarding service level specifications) any failure by the Institution or any Responsible Authority, utility or other like body to carry out works or provide services;

(c) any accidental loss or damage to the Works and/or the Facilities;

(d) any off-site failure or shortage of power, fuel or transport;

(e) any blockade or embargo which does not constitute an event of Force Majeure;

(f) the discovery of any heritage objects or resources that could not reasonably have been discovered by proper due diligence as contemplated in Clause [x] (Project Site Conditions);[283]

(g) any delay in obtaining any Consent; or

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280 In the interests of certainty in particular projects, for example, where the Services are needed for a hospital, a right to terminate should exist for both Parties in the event of prolonged occurrence of a Relief Event.

281 It is recommended that should these result in a prolonged delay, the Parties should meet in order to ascertain the best way of continuing with the Project, given the circumstances.

282 This list can be modified for specific sectors (for example, the unintentional introduction of a virus in an IT project) provided that the commercial risk of the occurrence of such events is still with the Private Party.

283 See Part D:15 (*Project Site: Heritage Resources*).

(h) *any official or unofficial strike, lockout, go slow or other such labour disputes generally affecting the [x] industry*[284] *or a significant sector of it,*

unless any of the events listed in Clauses (a) to (h) inclusive arises (directly or indirectly) as a result of any negligence, wilful conduct or default of the Private Party or any Subcontractor.

46.2 **Consequences**

46.2.1 The financial effects of delays caused by Relief Events are borne by the Private Party. As such, when these delays occur the Institution should pay no compensation. If a Relief Event occurs prior to Service Commencement, any Long Stop Date will be extended by a period equal to the relevant delay. In most cases the only relief given will be relief from termination and from liquidated damages for late completion of the Works, if any.

46.2.2 There should be no extension to the Project Term due to a Relief Event as such extension poses an unacceptable degree of risk for the Institution. This is because if an extension were given, then although the Private Party does not receive the Unitary Payment during a Relief Event (save to the extent the Services are available),[285] the Expiry Date would be extended by the duration of the Relief Event and the Private Party's revenue period would be kept whole. If an extension is given then there may be a reduced incentive on the Private Party to manage the effects of the Relief Event and restore the Services as soon as possible. In addition, the Institution's exposure to any risk it bears under the PPP Agreement is extended indefinitely as the Expiry Date may be continually extended. By extending the PPP Agreement, therefore, the Institution could be taking a substantial element of the risk of the occurrence of Relief Events.

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[284] This will be the principal industry relating to the Project. For example, in an accommodation Project, this will include the building maintenance or facilities management industries.

[285] This must be read in conjunction with Part H: (*Payment and Financial Matters*).

46.2.3 The Private Party should be relieved of any liability for liquidated damages for late completion of the Works, although Penalty Deductions should continue to be made where necessary in respect of the period of delay caused by the Relief Event (see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*) and Part H: (*Payment and Financial Matters*)).

46.2.4 When a Relief Event has occurred and the Institution has been informed, the Parties should consult on relevant issues, such as the likely duration of the Relief Event and the action to be taken to mitigate its effects. In the event of the discovery of any unforeseen heritage object or resources that result in a prolonged delay it may be necessary to provide for a mechanism by which the Parties can meet in order to find a solution that attempts to salvage the Project while being mindful of the impact of such prolonged Relief Event on the Private Party and the Project.

46.2.5 The Institution should not normally expect to exercise any step-in rights simply because of the occurrence of a Relief Event (see Part O: (*Step-in*)). If the Private Party is not using reasonable endeavours to remedy matters and mitigate the consequences, it will not obtain the relief afforded by Relief Events (which should always be subject to the Private Party's obligation to mitigate) and will be at risk of termination for Private Party Default. This should provide a sufficient incentive for the Private Party to perform (depending, in part, on the approach taken to relief from other obligations under the PPP Agreement).[286]

Standard Clause

<u>Consequences of a Relief Event</u>

(a) If and to the extent that a Relief Event:

(i) directly causes a delay in Service Commencement; and/ or

(ii) materially adversely affects the ability of the Private Party to perform any of its obligations under this PPP Agreement,

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[286] How long "prolonged" is will depend on the particular Project. It should in any event not be less than six months.

then the Private Party shall be entitled to apply for relief from any rights of the Institution arising under Clause [x] (Termination for Private Party Default) and Clause [y] (Liquidated Damages)[287].

(b) *To obtain relief, the Private Party must:*[288]

(i) *as soon as practicable, and in any event within [x] days after it became aware that the Relief Event has caused or is likely to cause delay and/or materially adversely affect the ability of the Private Party to perform its other obligations, give to the Institution a notice of its claim for relief from its obligations under this PPP Agreement, including full details of the nature of the Relief Event, the date of occurrence and its likely duration;*

(ii) *within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details of the relief claimed; and*

(iii) *demonstrate to the reasonable satisfaction of the Institution that:*

(aa) *the Private Party and its Subcontractors could not have avoided such occurrence or consequences by steps which they might reasonably be expected to have taken, without incurring material expenditure;*

(bb) *the Relief Event directly caused the delay to the Scheduled Service Commencement Date [or the need for relief from other obligations under this PPP Agreement];*

(cc) *the time lost and/or relief from the obligations under this PPP Agreement claimed could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice, without incurring material expenditure; and*

(dd) *the Private Party is using reasonable endeavours to perform its obligations under this PPP Agreement.*

(c) *In the event that the Private Party has complied with its obligations under Clause (b) above, then:*

(i) *the Scheduled Service Commencement Date shall be postponed by such time as shall be reasonable for such a Relief Event, taking into account the likely effect of delay; and/or*

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287 Generally, Relief Events should give only relief from the risk of termination for failure to achieve Service Commencement or perform the Services and relief from liquidated damages to the extent payable to the Institution. The performance regime should still apply so that Penalty Deductions may still accrue (save for termination purposes) and this should be made clear.

288 The approach here is to set out a quick procedure so that relief can be given or refused on a sensible timescale without additional delays.

(ii) *the Institution shall not be entitled to exercise its rights to terminate this PPP Agreement under Clause [x] (Termination for Private Party Default) or its right to claim liquidated damages under Clause [y] (Liquidated Damages) [and, subject to Clause (d) below, shall give such other relief as has been requested by the Private Party and agreed between the Parties or decided pursuant to Clause [x] (Fast-track Dispute Resolution)].*

(d) *[Nothing in Clause (c) above shall affect any entitlement to make Penalty Deductions*[289] *or any deductions made as a result of [Part H: (Payment and Financial Matters)] during the period in which the Relief Event is subsisting].*

(e) *In the event that information required by Clause (b) above is provided after the dates referred to in that Clause, then the Private Party shall not be entitled to any relief during the period for which the information is delayed.*

(f) *The Private Party shall notify the Institution if at any time it receives or becomes aware of any further information relating to the Relief Event, giving details of that information to the extent that such information is new or renders information previously submitted materially inaccurate or misleading.*

(g) *In the event of a Relief Event stipulated in Clause [x]*[290] *that continues for a period in excess of [x]*[291] *the Parties shall meet in order to find a mutually satisfactory solution for dealing with such prolonged Relief Event.*

(h) *If the Parties cannot agree on the extent of the relief required, or the Institution disagrees that a Relief Event has occurred or that the Private Party is entitled to any [extension of the Scheduled Service Commencement Date and/or relief from other obligations under this PPP Agreement], the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).*

47 COMPENSATION EVENTS

47.1 Purpose and Scope

47.1.1 Compensation Events are designed to cater for delays which arise before the Service Commencement Date as a result of an Institution breach and which result in a delay to Service Commencement and/or increased costs

[289] Penalty Deductions that accrue as a result of a Relief Event should be suspended in relation to the Institution's right to terminate the PPP Agreement, but not in relation to the Institution's right to make Penalty Deductions against the Unitary Payment.

[290] This refers to Relief Events involving the discovery after the Signature Date of any heritage resource that could not have been discovered earlier through the exercise of reasonable due diligence (as contemplated in Part D:15.3 (*Project Site: Heritage Resources*)). It does not refer to the discovery of any existing building or infrastructure on the Project Site that is a protected heritage resource as the heritage status of all existing buildings and infrastructure on the Project Site is a Private Party risk (see Part D:15.2 (*Project Site: Heritage Resources*)).

[291] This will depend on the specific project. A period (usually not longer than 180 days) must, however, be inserted.

to the Private Party. Compensation Events also cover increased costs during the Service Period as a result of any breach by the Institution of its obligations during the Service Period (which includes a breach occasioned by third parties for whom the Institution is responsible, such as teachers or doctors). Such events are more appropriately dealt with by compensating the Private Party as opposed to constituting Institution Default. As mentioned in Part J: (*Relief Events, Compensation Events and Force Majeure*), it may, after careful consideration in certain projects, be appropriate to add other (or sector) specific events.

47.1.2 The Institution should carefully consider the nature of its obligations during the Service Period. If the Institution has significant ongoing obligations and breach of such obligations would adversely affect the Private Party's ability to perform (for example, if the Institution failed to carry out procedures for certifying operating matters) or affect the cost of performance, then such breaches should result in a Compensation Event for which the Institution should compensate the Private Party, unless such breach is expressly compensated for elsewhere in the PPP Agreement.[292]

Standard Definition

*"**Compensation Event**" means any breach by the Institution of any of its obligations under this PPP Agreement (save for any breach that constitutes an Institution Default) to the extent in each case that the breach is not caused or contributed to by the Private Party or any Subcontractor.*

47.2 Consequences

47.2.1 The practical consequence of a Compensation Event occurring during the Works phase is that the Service Commencement Date will need to be postponed, usually by the length of any delay caused (any Long Stop Date will similarly be extended). This means that the start date of the Private Party's revenue stream is also delayed and/or additional costs are incurred (subject to the Private Party's obligation to mitigate).

[292] The Private Party is also entitled to compensation from the Institution in respect of any indemnities given by the Institution; (see Part C:9 (*General Obligations: Indemnities and Claims for Damages*)); Institution Variations (see Part K:50 (*Unforeseeable Discriminatory Government Conduct and Variations: Variations*)); and Unforeseeable Conduct (see Part K:49 (*Unforeseeable Discriminatory Government Conduct and Variations: Unforeseeable Discriminatory Government Conduct*)).

A Compensation Event which occurs after Service Commencement may result in the Private Party's revenue stream being reduced or interrupted and/or additional costs being incurred. As a result, the Private Party may incur finance charges and additional costs which could involve the Private Party in significant expense.

47.2.2 The Parties must agree how to compensate the Private Party for any delay in Service Commencement or reduction or interruption of its revenue stream or additional costs incurred by it which result directly from a Compensation Event. The prescribed approach is to retain the original Expiry Date and compensate the Private Party for its loss. If possible, a set of financial and other tests may be agreed by the Parties at the Signature Date in order to calculate the compensation payable for possible categories of compensation. This does not mean that payment of the Unitary Payment[293] is to be made for a month in respect of which no Services have been provided although the monetary value of the compensation may be the same as the Unitary Payment.

47.2.3 If the PPP Agreement contains liquidated damages for late completion of the Works (see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*)), then the Private Party will also be relieved from liability for such liquidated damages for the period of delay caused by the Compensation Event. The Private Party should, of course, also be relieved of any other liability for the Institution's losses in respect of the Compensation Event. This should be taken into account in determining the consequences for the Institution of a Compensation Event.

47.2.4 The main advantages of the prescribed approach are firstly, simplicity and secondly, that funders should prefer it, since the debt cover ratios and internal rate of return on Equity can be preserved. This approach also means that the Institution has an incentive to manage its rights and

[293] This happens automatically in circumstances where the Private Party's revenue is derived from user charges as in the case of toll roads, where the charge may only be levied when the Services have been rendered.

obligations in the construction phase in a way that does not result in delay. The detail of how this approach should work in practice can be seen with reference to Section 47.3 (*Calculation of Compensation*), below.

47.2.5 If the Private Party is fully compensated for the delay, there is no need to extend the Expiry Date.

47.2.6 The Private Party must use reasonable endeavours to mitigate its losses and costs (for example, by rescheduling its Works programme or by redeploying staff). Such mitigation may result in there being no delay in the Service Commencement Date (although extra costs may result from the steps taken to mitigate).

47.3 Calculation of Compensation[294]

47.3.1 The Unitary Payment may need to be adjusted if the Compensation Event concerned involves additional cost[295] or a time delay which has cost and/or loss of revenue implications. It is important that the PPP Agreement contains an appropriate method for dealing with any payment variations that arise as a result of a Compensation Event. The Parties may at Signature Date agree on a set of financial and other tests to be used for the purposes of calculating the compensation payable for possible categories of compensation. Any agreement reached in respect of the value of the compensation payable should be final and not subject to change if it later transpires that the costs associated with such Compensation Event are greater (or less) than the amount agreed to. This is equally applicable to costs arising as a result of Variations and/or Unforeseeable Conduct (see Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*)).

[294] Payment of any compensation will be subject to the regulations regarding budgets (see Part H:37 (*Payment and Financial Matters: Unitary Payments*)).

[295] In terms of the Treasury Regulations, material amendments or amendments that change the risk profile or value for money considerations require the approval of the National Treasury. The Institution must ensure, at the relevant time, that it obtains the requisite approvals.

47.3.2 One common way of dealing with such events is to rely on the Financial Model to deal with the issue and for both Parties to use this to calculate how and when compensation should be paid. Typically this would require the Institution to agree that the debt service cover ratios and internal rate of return on Equity remain unchanged. While there is no objection in principle to the Parties referring to a Financial Model to calculate compensation payable for Compensation Events (and for that matter the effects of an Institution Variation or Unforeseeable Conduct (see Part K: (*Unforeseeable Discriminatory Government Conduct and Variations*)) provided both Parties fully understand all of the Financial Model's various aspects, there are several principle problems that can arise in using a Financial Model:

47.3.2.1 the Financial Model may obscure the process being followed in reaching the answer, unless there is clarity on all sides on how the relevant formulae used in the model work. For example, if something has happened which was not originally modelled for and audited, there could be conflict arising on how to model it, which could impact on the calculation concerned;

47.3.2.2 if the Institution has access to the Financial Model in sufficient detail and to all of the internal costs, returns and other assumptions (to the level of detail required), then more information than is relevant simply to value the consequences of the event may have to be provided by the Private Party, which may not be acceptable to it (and, in addition, certain of the assumptions may need to be updated); and

47.3.2.3 the result of preserving the ratios and internal rate of return on Equity can be achieved in a number of different ways (see Section 47.3.5).

A simple approach is recommended since the aim of this Section 47.3 is to ensure fair compensation for a limited number of events calculable in a relatively straightforward manner. If the Unitary Payment is to change, then financial advice is necessary.

47.3.3 The prescribed approach to Compensation Events that may lead to a change in the Unitary Payment is as follows:

47.3.3.1 if the event concerned requires Capital Expenditure (whether before or during the Service Period), then in most cases, it will be more practicable to deal with this by means of a lump-sum reimbursement (subject to the possibility of interim payments[296]); and

47.3.3.2 if the event concerned requires a change in operating costs, then an adjustment in the Unitary Payment is the appropriate means of payment.

In the event of an Institution breach it is also acceptable for the Institution simply to reimburse the Private Party on the basis of actual costs incurred (for example, as a result of any delay in giving an approval).[297]

47.3.4 The approach of a lump-sum reimbursement and/or adjustment of the Unitary Payment ensures that a minimum of additional financing costs is incurred. Other reasons, including affordability constraints, may, however, mean that the Institution wishes to reserve the right to ask the Private Party to use reasonable endeavours to finance the event where Capital Expenditure is required. If this is done, then careful scrutiny of the value for money implications should be undertaken.

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[296] Significant Institution Variations are likely to be acceptable to the Private Party only if compensation is paid by the Institution so as to match the timing of the agreed costs of the Variation.

[297] Where there is no Unitary Payment but the Private Party is compensated from user charges, an adjustment of the user charges is problematic because the setting of tariffs is a regulatory function that cannot be fettered and that may not be delegated to a Private Party. Also, as these user charges are often paid directly by the public, adjustments in user charges run the risk of public protestor action. Adjusting user charges may therefore not be feasible and any payment to the Private Party as a result of, for example, a change in operating costs, may have to be made by way of a payment by the Institution.

47.3.5 Where the compensation involves an increased obligation to incur Capital Expenditure, other possibilities[298] include:

47.3.5.1 a lump-sum payment from the Institution paid immediately on Service Commencement. The amount of the lump-sum should exceed the amount of the relevant increase in Capital Expenditure by any incremental increase in financing costs as a result of a more frequent drawdown of Debt than originally anticipated and the agreed costs incurred in arranging any such financing;

47.3.5.2 an adjustment to the Unitary Payment to take account of the Private Party's increased debt service obligations as a result of funding the event concerned. This adjustment would be appropriate to the actual terms and conditions of the funding, which would have been known to and approved by the Institution, and be applied on the basis that the funders are no worse and no better off, from the perspective of risk and return, than they would have been had the increase in Capital Expenditure not arisen. As stated above, in practice this generally means that an increase is made to the Unitary Payment (over the term of amortisation of the additional dedicated funding) to restore the debt service cover ratios and the return on Equity to their values had the additional funding not been required. This calculation can only be made by using the Financial Model. This approach can be problematic. The Institution should not seek a grace period on paying a higher Unitary Payment even if this would satisfy the debt service cover ratios and return on Equity (as this could cause inappropriate distortion to the cash flow profile); or

47.3.5.3 particularly if the Institution cannot afford to pay compensation in the form of a lump-sum but wishes to avoid having to use the Financial Model, it may offer to pay a supplementary Unitary

[298] Particularly to avoid the time and expense of engaging advisors for what may be minor compensation sums (if this approach is used), it is recommended that the Parties agree and record in the PPP Agreement the incremental impact on the Unitary Payment of minor Capital Expenditure and operational expenditure changes.

Payment over a stipulated period in the form of an annuity equivalent of the Capital Expenditure. If this approach is adopted, the discussion can be reduced to a single issue, namely, the annuity rate to be applied. In this case, the Institution need not be concerned with how and at what cost the Private Party has arranged additional dedicated funding, if any.[299] As this supplementary payment is not dependent on the Project performance, an appropriate rate would be that applicable to instalment payments by the Institution of any compensation on termination.

47.3.6 If the event concerned involves a Capital Expenditure reduction (for example, cancellation of a wing of a building), it may not be possible to reduce the Unitary Payment as this is unlikely to be acceptable to the Shareholders.

47.3.7 If the compensation arises only because of a change in operating costs then appropriate changes to the Unitary Payment should be by negotiation between the Parties. The change in the Unitary Payment should be made at the time of the Compensation Event so as to reflect forecast operating costs changes, as to amount and timing. The use of lump-sum compensation payments or annuity equivalents is also inappropriate for changes in operating costs. As many of the above issues have complicated financial consequences, financial advisors should be consulted as to the most appropriate approach for a particular project.

47.3.8 In any event (even if this approach is taken in relation to Variations and Unforeseeable Conduct), it is not appropriate in any circumstances for a breach by the Institution of its obligations to give rise to an obligation on the Private Party to finance any Capital Expenditure consequences.[300]

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[299] If the original Unitary Payment over the chosen annuity payment period is profiled, then the supplementary Unitary Payment should similarly be profiled. Annuities based upon nominal discount rates would be excluded from any indexation provisions of the Unitary Payment.

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

47.3.9 In assessing the consequences of a Compensation Event, other causes of delays to the Service Commencement Date will be relevant as to whether the Private Party will receive relief from its obligations and/or compensation. The Private Party's losses should be calculated as accurately as possible at the time and appropriate payment made.

Standard Clause

Consequences of a Compensation Event

(a) *If, as a direct result of the occurrence of a Compensation Event:*[301]

(i) *the Private Party is unable to achieve Service Commencement on or before the Scheduled Service Commencement Date;*

(ii) *the Private Party is unable to comply with its obligations under this PPP Agreement; and/or*

(iii) *the Private Party incurs costs or loses revenue,*[302]

then the Private Party is entitled to apply for relief from its obligations and/or claim compensation under this PPP Agreement.

(b) *To obtain relief and/or claim compensation the Private Party must:*

(i) *as soon as practicable, and in any event within [x] days after it became aware that the Compensation Event has caused or is likely to cause delay, breach of an obligation under this PPP Agreement and/or the Private Party to incur costs or lose revenue, give to the Institution a notice of its claim for an extension of time for Service Commencement, payment of compensation and/or relief from its obligations under this PPP Agreement;*

(ii) *within [x] days of receipt by the Institution of the notice referred to in Clause (b)(i) above, give full details*[303] *of the Compensation Event and the extension of time and/or any estimated change in project costs claimed;*[304] *and*

(iii) *demonstrate to the reasonable satisfaction of the Institution that:*

[301] In the event of a delay to the Scheduled Service Commencement Date, the construction costs will most likely increase due to a longer financing period. The Private Party is under a duty to mitigate its other costs associated with any delay (for example, by delaying recruitment, if this can be done).

[302] This loss means not only out-of-pocket costs but also a claim for loss of profits (including a lost completion bonus), if any, caused directly by the Compensation Event.

[303] The Institution and the Private Party may wish to specify in the PPP Agreement precisely what details are required.

[304] This figure will not calculate the compensation payable, but it gives an indication of the seriousness of the breach and so indicates what steps should be taken by way of mitigation.

(aa) the Compensation Event was the direct cause of the estimated change in project costs and/or any delay in the achievement of the Scheduled Service Commencement Date; and

(bb) the estimated change in project costs, time lost, and/or relief from the obligations under the PPP Agreement claimed, could not reasonably be expected to be mitigated or recovered by the Private Party acting in accordance with Good Industry Practice.

(c) In the event that the Private Party has complied with its obligations under Clause (b) above, then:

(i) the Scheduled Service Commencement Date shall be postponed by such time as shall be reasonable for such a Compensation Event, taking into account the likely effect of delay;[305]*and*

(ii) in the case of an additional cost being incurred by the Private Party:

(aa) on or before the Service Commencement Date; or

(bb) as a result of Capital Expenditure being incurred by the Private Party at any time,

the Institution shall compensate the Private Party for the actual estimated change in project costs as adjusted to reflect the actual costs reasonably incurred within [x] days of its receipt of a written demand by the Private Party supported by all relevant information;[306]

(iii) in the case of a payment of compensation for the estimated change in project costs that does not result in Capital Expenditure being incurred by the Private Party but which reflects a change in the costs being incurred by the Private Party after the Service Commencement Date, the Institution shall compensate the Private Party in accordance with Clause (f) below by an adjustment to the Unitary Payment; and /or

(iv) the Institution shall give the Private Party such relief from its obligations under this PPP Agreement, as is reasonable for such a Compensation Event.

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[305] This is only necessary if there is a Long Stop Date. If the Private Party is required to pay the Institution liquidated damages for failure to achieve Service Commencement by the Scheduled Service Commencement Date, the Institution should consider how the Private Party's obligation to pay will be relieved if a Compensation Event occurs after the Scheduled Service Commencement Date but prior to actual Service Commencement.

[306] This payment can be in the form of monthly payments as expenditure is incurred (or staged payments against milestones) and invoiced if the delay is for a significant period of time.

(d) *In the event that information is provided after the dates referred to in Clause (b) above, then the Private Party shall not be entitled to any extension of time, compensation, or relief from its obligations under this PPP Agreement in respect of the period for which the information is delayed.*

(e) *If the Parties cannot agree on the extent of any compensation, delay incurred, or relief from the Private Party's obligations under this PPP Agreement, or the Institution disagrees that a Compensation Event has occurred (or as to its consequences), or that the Private Party is entitled to any relief under this Clause, the Parties shall resolve the matter in accordance with Clause [x] (Fast-track Dispute Resolution).*

(f) *Any payment of compensation referred to in Section (c) (iii) above shall be calculated in accordance with [Clause [x] (Calculation of Compensation) above].*[307]

48 FORCE MAJEURE

48.1 Introduction

48.1.1 Relief Events include several events which have often been included in the definition of Force Majeure. As the remedies available under Relief Events deal adequately with the consequences of such events, there is no need for the all-encompassing definition of Force Majeure that has been common in many contracts concluded to date. Force Majeure should be defined to include those very limited events which are out of the control of both Parties and which, if they continue for a certain period of time,[308] can result in termination of the PPP Agreement. Force Majeure should only include those events that are likely to have a material adverse consequence on either Party's[309] ability to fulfil its obligations under the PPP Agreement and which are uninsurable. As events of Force Majeure are usually highly unlikely events that are beyond the control of both Parties with neither Party being in any better position to bear such risk, the consequences of an event of Force Majeure should be shared between the Parties.

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307 The Institution should not agree to a provision whereby, after the relevant effects of the Compensation Event have been calculated, there is an adjustment of the compensation if the costs are greater or lesser than those agreed or estimated.

308 Usually six months, but this may vary depending on the particular project.

309 Usually the Private Party's.

48.1.2 The Party claiming the occurrence of an event of Force Majeure is only excused from performance to the extent that it is unable to comply with all or a material portion of its obligations under the PPP Agreement. Either Party may terminate the PPP Agreement as a result of an event of Force Majeure, only if the Parties are unable, within the specified period, to agree on how best to continue the Project in light of the Force Majeure event (See Part N:66 (*Termination: Compensation on Termination for Force Majeure*)).

48.1.3 For so long as the event of Force Majeure continues, the Institution is only liable to pay the Private Party for Services actually made available by the Private Party. Any payment by the Institution should take into account any reduction in the Private Party's operating costs due to the Force Majeure event preventing substantial performance. The Private Party should not be entitled to any amount simply to ensure that it is in a position to meet its debt service obligations in whole or in part as its debt service reserve account should cover this.

48.2 **Consequences of Force Majeure**

48.2.1 When either Party claims the occurrence of an event of Force Majeure, the Parties should meet in order to find a mutually acceptable solution for the continuation of the Project. Such solution may include the following:

48.2.1.1 the reinstatement of the Facilities, although neither Party would be obliged to do this;

48.2.1.2 adjustment of the Services requirements and/or output specifications;

48.2.1.3 amending the payment mechanism; and/or

48.2.1.4 the extension of the Project Term.

48.2.2 The solution will depend on the nature of the event and its effects on the particular Project.

48.2.3 If the Parties cannot agree on a solution within the stipulated period, either Party should be entitled to terminate the PPP Agreement with compensation payable to the Private Party as set out in Part N:66 (*Termination: Compensation on Termination for Force Majeure*).

Standard Definition

*"**Force Majeure**" means any of the following events to the extent that they are uninsurable:*

(a) war, civil war, armed conflicts or terrorism; or

(b) nuclear contamination unless the Private Party and/or any Subcontractor is the source or cause of the contamination; or

(c) chemical or biological contamination of the Works and/or the Facilities and/or the Project Site from any of the events referred to in Clause (i) above,

which directly causes either Party to be unable to comply with all or a material part of its obligations under this PPP Agreement.

Standard Clause

<u>Force Majeure</u>

(a) Subject to Clauses (b)(ii) and (iii) the Party claiming relief shall be relieved from liability under this PPP Agreement to the extent that by reason of the Force Majeure event it is not able to perform all or a material part of its obligations under this PPP Agreement.

(b) Where a Party is (or claims to be) affected by an event of Force Majeure:

(i) it shall take all reasonable steps to mitigate the consequences of such an event upon the performance of its obligations under this PPP Agreement, resume performance of its obligations affected by the event of Force Majeure as soon as practicable and use all reasonable endeavours to remedy its failure to perform; and

(ii) it shall not be relieved from liability under this PPP Agreement to the extent that it is not able to perform, or has not in fact performed, its obligations under this PPP Agreement due to its failure to comply with its obligations under sub-Clause (b)(i).

(c) The Party claiming relief shall serve written notice on the other Party within [x][310] Business Days of it becoming aware of the relevant event of Force Majeure. Such initial notice shall give sufficient details to identify the particular event claimed to be an event of Force Majeure.

(d) A subsequent written notice shall be served by the Party claiming relief on the other Party within a further [x] Business Days which shall contain such relevant information relating to the failure to perform (or delay in performing) as is available, including (without limitation) the effect of the event of Force Majeure on the ability of the Party to perform, the action being taken in accordance with Clause (b)(i), the date of the occurrence of the event of Force Majeure and an estimate of the period of time required to overcome it (and/or its effects).

(e) The Party claiming relief shall notify the other as soon as the consequences of the event of Force Majeure have ceased and when performance of its affected obligations can be resumed.

(f) If, following the issue of any notice referred to in Clause (d), the Party claiming relief receives or becomes aware of any further information relating to the event of Force Majeure (and/or any failure to perform), it shall submit such further information to the other Party as soon as reasonably possible.

(g) During the continuance of any event of Force Majeure which occurs on or after the Service Commencement Date the Unitary Payment payable in respect of such period shall be reduced to an amount equivalent to the Unitary Payments payable in respect of those Services that are available to the Institution during such period after taking account of the effects of such event of Force Majeure.

(h) If an event of Force Majeure occurs before the Service Commencement Date, the Private Party shall not be entitled to receive any payment in respect of the Unitary Payment.

(i) Subject to Clause [x][311] the Private Party's sole right to payment or otherwise in relation to the occurrence of an event of Force Majeure shall be as provided in this Clause.

(j) The Parties shall endeavour to agree any modifications to this PPP Agreement which may be equitable having regard to the nature of an event or events of Force Majeure. Clause [x] (Fast-track Dispute Resolution) shall not apply to a failure of the Institution and the Private Party to reach agreement pursuant to this sub-Clause.

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310 In IT projects "immediate" notice is usually required.

311 The Clause providing for compensation on termination for Force Majeure. See Part N:66 (*Termination: Compensation on Termination for Force Majeure*).

PART K: UNFORESEEABLE DISCRIMINATORY GOVERNMENT CONDUCT AND VARIATIONS

49 UNFORESEEABLE DISCRIMINATORY GOVERNMENT CONDUCT

49.1 Introduction

49.1.1 The Private Party is obliged under the PPP Agreement to comply with all applicable law. A failure to comply could give rise to termination for Private Party Default (see Part N:60 (*Termination: Causes of Termination*)). The cost of complying with law that is current or foreseen at the Signature Date is usually built into the price which the Private Party bids in order to provide the Services. It may, however, not be possible for the Private Party to price specific costs that may arise from changes in law which are not foreseen at the Signature Date. The issue then is who should be responsible for the costs arising from changes in law and how such costs should be funded.

49.1.2 In addition, Private Parties often also seek relief from the consequences of any actions or omissions by Responsible Authorities that do not constitute changes in law but which may affect the return on Equity, debt service or otherwise result in any increase in costs to the Private Party. Private Parties argue that they submit bids on the basis that they will not be materially adversely affected by such unforeseeable discriminatory conduct on the part of government, whether as a result of a change in law or any act or omission by any Responsible Authority. However, this presumption is usually misplaced.

49.1.3 In this Standardisation, “Unforeseeable Conduct” refers to both changes in law including statutes, regulations and by-laws as well as any act or omission by any Responsible Authority and the Institution to the extent that such act or omission is not covered by the other terms of the PPP Agreement.

49.2 Private Party's and Institution's Concerns

The Private Party's concern is that Unforeseeable Conduct is a risk which it cannot control and which it regards as being within the control of the Institution or wider government. Under its contracts with other private sector parties, the Private Party is usually able to pass on the costs of Unforeseeable Conduct to its customers through an increase in price or, in contracts of relatively short duration, is able to take a view on the prospects of Unforeseeable Conduct arising during the term of the contract. As the prices in PPPs are agreed on a long-term basis and are not flexible in the same way, the Private Party may believe that it should not have to bear the costs of Unforeseeable Conduct. In practice, however, many Institutions exert negligible, if any, influence over Unforeseeable Conduct by wider government. Furthermore, the private sector has in all other contexts successfully managed to absorb the effects of such Unforeseeable Conduct and minimise the full effect of price changes to its customers. In addition, there is no reason why Private Parties should be in any better position regarding the consequences of Unforeseeable Conduct than their counterparts in non-PPP endeavours, except where the Unforeseeable Conduct discriminates against them because they are engaged in a PPP. The Institution must not reduce the Private Party's incentive to manage its costs even where it agrees to meet the Private Party's costs resulting from Unforeseeable Conduct.

49.3 Allocation of Risk of Unforeseeable Conduct

49.3.1 In some projects, it is possible to treat Unforeseeable Conduct of any type as being at the Private Party's risk, particularly in projects in which such costs can be passed on to the users of the project. It is, however, not always possible to pass this increase in costs on to the users, especially where the user tariff is one set by the Institution or a Responsible Authority not a party to the PPP Agreement (see Part J: (*Relief Events, Compensation Events and Force Majeure*)). This is also not possible where the main user is the Institution. In instances where the risks cannot be quantified or passed on to third party users, a risk sharing approach should be developed.

49.3.2 The risk of Unforeseeable Conduct that is of a general nature in that it does not discriminate against the Private Party should be borne by the Private Party. Unforeseeable Conduct that discriminates against the Private Party, either as an individual entity[312] or more likely as a member of a specific group of entities (for example all private parties in PPP Agreements) should generally be the Institution's risk.

49.3.3 In addition to the Unforeseeable Conduct having to be discriminatory in order for the Institution to compensate the Private Party, the Unforeseeable Conduct which the Private Party complains of must not only have been unforeseeable by a reasonable person in the position of the Private Party at the Signature Date, it must also have in fact been unforeseen by the Private Party at such date. If the conduct was actually foreseen by the Private Party or ought reasonably to have been foreseen (that is, was foreseeable) by the Private Party, it will not constitute Unforeseeable Conduct. Accordingly, the Private Party should bear the risk in relation to that conduct and the Institution should not compensate the Private Party for any loss.

49.3.4 To the extent that any conduct is specifically dealt with elsewhere in the PPP Agreement, such conduct should not constitute Unforeseeable Conduct and the Private Party should not be entitled to any relief pursuant to the Unforeseeable Conduct provisions.

49.4 Mitigation

49.4.1 Whenever the Institution bears some of the risk of Unforeseeable Conduct, the Private Party must be obliged to use all reasonable endeavours to mitigate any cost increases. This duty to mitigate should also require the Private Party to foresee and anticipate the effect of any Unforeseeable Conduct, particularly in relation to planned expenditure that is in the ordinary course of business.

[312] This is unlikely in the case of a change in law because laws do not usually refer to individual entities or persons, but rather to groups with specific characteristics.

49.4.2 In the event that the Parties agree or it is determined pursuant to dispute resolution procedures that any Unforeseeable Conduct has occurred, the Private Party should be entitled to relief from the Institution. The Institution should be entitled to decide how best to compensate the Private Party for its losses provided that the compensation paid puts the Private Party in the same overall economic position it would have been in had the Unforeseeable Conduct not occurred.

Standard Definition

*"**Unforeseeable Conduct**" shall occur if, after the Signature Date, the Institution or any Responsible Authority takes any action (including the introduction, application, or change of any law, regulation, by-law or order having the force of law) or fails to carry out its obligations as prescribed by law; and*

(a) the principal effect of which is directly borne by:

(i) the Project and not other similar PPPs;

(ii) the Private Party and not other persons; or

(iii) parties undertaking PPPs and not other persons;

(b) in respect of which the Private Party is not entitled to any other relief pursuant to any other provisions of this PPP Agreement;

(c) which was not foreseen by the Private Party on or before the Signature Date; and

(d) which could not reasonably have been foreseen by any person in the position of the Private Party on or before the Signature Date;

provided that:

(aa) Unforeseeable Conduct shall be deemed not to have occurred under circumstances where any action or omission of the Institution or Responsible Authority is in direct response to any act or omission of the Private Party which is illegal (other than an act or omission rendered illegal by virtue of such conduct of the Institution or Responsible Authority) or in violation of agreements to which the Private Party is a party;

(bb) an increase in taxes of general application which does not discriminate against the Private Party or against the Private Party and other parties undertaking PPPs shall be deemed not to be Unforeseeable Conduct; and

(cc) Unforeseeable Conduct shall be deemed not to have occurred if such conduct by the Institution or any Responsible Authority is required as a result of an event of Force Majeure and is reasonably proportionate thereto.

Standard Clause

Unforeseeable Conduct

(a) Should any Unforeseeable Conduct occur which materially and adversely affects the general economic position of the Private Party, the Private Party shall be entitled to such compensation and/or relief from the Institution as shall place the Private Party in the same overall economic position as the Private Party would have been in but for such Unforeseeable Conduct.

(b) Should any Unforeseeable Conduct occur which materially beneficially affects the general economic position of the Private Party, the Private Party shall pay the value of such benefit to the Institution so that the Private Party remains in the same overall economic position it would have been in had the materially beneficial Unforeseeable Conduct not occurred.

(c) The Party claiming the occurrence of the Unforeseeable Conduct ("Claiming Party") shall give written notice to the other Party ("Receiving Party") containing reasonable particulars of such conduct and its likely economic consequences to the Private Party.

(d) The Receiving Party shall have 60 (sixty) days from the date of receipt of such notice to effect a remedy for the Unforeseeable Conduct which restores the general economic position of the Private Party to that which it would have been in if such Unforeseeable Conduct had not occurred. If the Receiving Party does not effect such a remedy within such period, the Parties shall consult within 10 (ten) Business Days after the expiration of such period with a view to reaching a mutually satisfactory resolution of the situation. In the event that a mutually satisfactory resolution has not been reached within such 10 (ten) Business Day consultation period, the matter shall be dealt with in accordance with Clause [x].[313]

(e) In so far as the Private Party is the Claiming Party, it shall use all reasonable endeavours to minimise and mitigate the effects of any Unforeseeable Conduct.

[313] This should refer to the ordinary dispute resolution provisions.

50 VARIATIONS

50.1 Introduction

50.1.1 The output specifications, which are set out in the PPP Agreement, should take into account the Institution's current as well as its future requirements to the extent that these are identifiable and quantifiable.

50.1.2 Variations to the output specifications may, however, be necessary to cater for changes in the Institution's requirements which could not be anticipated or quantified at Signature Date or changes imposed by external factors for which the Institution has retained responsibility (for example, a change of policy). The relevant Treasury must be notified of all Variations prior to their implementation. Variations which impact on affordability and/or result in an increase in the Unitary Payment will require a new TA:I.

50.1.3 The Private Party may also wish to propose Variations either to the output specifications themselves or to the way in which it delivers the Services. Although the output specifications should not prescribe the method of delivery of the Services, there may be circumstances where aspects of the method of delivery impact on the Services requirements and are therefore critically important to the Institution. In such circumstances, the Institution will wish to be consulted formally prior to the implementation of the changes.

50.1.4 The key issue regarding Variations proposed by either Party is whether such Variations are mandatory and how the cost (if any) of implementing such Variations is to be allocated. The PPP Agreement should therefore contain a mechanism by which Variations may be proposed by either Party and evaluated and approved prior to implementation.

50.2 Factors to Consider

50.2.1 A proposed Variation may involve changes to the Works and/or the Services. Depending on the nature of the Variation, costs may be incurred in implementing such Variation, which were not originally anticipated. Changes to the Services that involve additional capital or operating costs are generally not priced for by the Private Party. Both the Private Party and its funders may be concerned that Variations will have an adverse impact on the Project's economics. The Private Party should not be required to increase its contingency funding supply to cover possible Institution Variations as this may not provide value for money especially where the Variation is not necessary.

50.2.2 While the PPP Agreement must cater for the flexibility required to meet major Variations in the Institution's operating environment, such changes should be minimised where possible as they are likely to involve lengthy and possibly costly negotiations with the Private Party and its funders.

50.2.3 Variations that result in the Private Party's risk profile being adversely affected are unlikely to be acceptable to the Private Party. If it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that any Variation will adversely affect the Private Party's risk profile, the Private Party should be entitled to veto such Variation without the Institution having recourse to the fast-track dispute resolution procedure.

50.2.4 Some Variations may, of course, involve no additional costs and may even reduce certain costs. The Parties will then need to agree upon the best way to pass through such savings to the Institution (in the case of an Institution Variation) or to end users, or to share such savings (in the case of a Private Party Variation). Where Variations involve a decrease in the scope of the Services this may not be implemented without the consent of the Private Party. Provided that it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that the Variation will result in a decrease in the scope of the Services, the Private Party's failure to grant consent should not be subject to the fast-track dispute resolution procedure. The remainder of this Part assumes that Variations (whether generated by the

Institution or the Private Party) will lead to additional costs being incurred.

50.3 **Institution Variations**

50.3.1 Institution Variations should be limited to changes to the Services requirements, the specified constraints on inputs and the limits or scope of the Project Insurances.[314] The form of the Variation should be a restatement of the original specification.

50.3.2 In some projects, Institution Variations may be quite foreseeable. In such circumstances, where the Institution's future requirements are reasonably well known, the Institution should consider the feasibility of requiring the Private Party to commit to pricing pre-specified Variations as part of the PPP Agreement (for example, unit prices and labour rates). It is however unlikely that the Institution will be able to foresee all Variations.

50.3.3 In all PPP Agreements, there is an inevitable tension between cost and flexibility. The cheapest Unitary Payment may provide the Institution with the least flexibility in managing the PPP Agreement since the ability to absorb unforeseen changes and risks inevitably comes at a price. To preserve flexibility in managing the PPP Agreement, the Institution must carefully assess whether or not it requires pre-priced options to vary scope, pre-priced unit rates for additional capacity of service delivery, comprehensive rights to insist on benchmarking market costs, open book accounting and cost transparency linked to prescribed margins for pre-agreed risk profiles.

50.3.4 Institution Variations during the Works phase should, where possible, be kept to a minimum. In exceptional circumstances the Private Party may, however, be able to incorporate, relatively cheaply, such a Variation during the Works phase that would become very expensive once the

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

Services have commenced. The PPP Agreement should incorporate provisions to reflect this possibility.

50.3.5 The recommended Institution Variation procedure for all Variations other than Small Works Variations[315] is set out below. Initially, the Institution should serve a notice setting out the intended Variation and require the Private Party to provide an estimate of the technical, financial, contractual and timetable implications of the change within, say, 21 days. The Private Party should by this stage have been entitled to set out any reasons why the Institution was not entitled to seek such a Variation (or whether and for what reason it resists such a Variation). The intention at this stage is for the Private Party to provide quickly an estimate of the implications of the change.

50.3.6 The Institution should recognise that the Private Party's funders, in particular, are unlikely to allow the Private Party to agree to any Variation that would increase project or financing risk, and, as such, the sponsors are unlikely to allow the Private Party to agree to any Variation that would reduce the rate of return. Such limits must be reasonable. The Private Party should, therefore, have a right to veto a Variation that would adversely affect its risk profile. If the Private Party is fully protected against the consequences of an Institution Variation and how it is to be paid for there should be no objection by its funders or sponsors.

50.3.7 In considering whether the Private Party's objections are reasonable, the Institution should take into account all relevant circumstances. For example, if it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that the Variation will adversely affect the Private Party's risk profile, the Private Party should have a right to veto such a Variation without the Institution having recourse to the fast-track dispute resolution procedure. It would

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[315] See Section 50.5 (*Small Works Variations*).

also be reasonable for the Private Party to object to an Institution Variation that would result in a change in the nature of the Project.

50.3.8 If it has been established (either by agreement between the Parties or pursuant to the fast-track dispute resolution procedure) that the Variation will adversely affect the risk profile of the Private Party the Institution should not be entitled to proceed with the Variation.

50.3.9 If the Variation does not adversely affect the risk profile of the Private Party and the Institution still wishes to proceed with the Variation, the Private Party and the Institution should meet to discuss its implications. If the Variation is sufficient to require the Private Party to seek additional funding, this may not be secured until after the Institution has committed fully to implementing the Variation. It is therefore necessary to seek "reasonable endeavours" commitments for the Private Party to put the funding in place. If the Private Party is unable to put the funding in place, the Institution should reserve the right to fund the Variation through another method (for example, by providing the necessary funding itself). The Institution must ensure that the funding provided represents value for money.

50.3.10 The estimates and quotations should be a fair estimate of the likely implications of the Variation. Nevertheless, the Institution should ensure that it is paying a reasonable price to implement the Variation by including provisions within the PPP Agreement that:

50.3.10.1 make clear the duty of the Private Party to mitigate the costs;

50.3.10.2 ensure that there is transparency of information on costings;

50.3.10.3 where the Variation is to be implemented by a Subcontractor, provide where possible for competitive quotes to be obtained; and

50.3.10.4 where the Variation is to be implemented by the Private Party, provide for the cost to be benchmarked against prevailing market rates.

50.3.11 If the Institution decides not to proceed with the Variation then this may have given rise to the Private Party incurring costs in estimating the cost of the Institution Variation. On the other hand, the Private Party may, in practice, seek to resist changes by quoting unrealistically high prices. The Private Party should have no automatic right to recover all of its costs associated with pricing the Variation as many of them will be internal costs that are already factored into its overhead provisions. If reimbursement is to be made, it should only cover reasonable additional costs. The following factors are relevant in determining whether this is appropriate:

50.3.11.1 the steps that have been undertaken by the Private Party to produce a reasonable estimate, and steps that would have been taken if the Private Party was producing its estimate in a competitive context;

50.3.11.2 the extent to which the Institution has access to the cost elements of the estimate (that is, its component parts can be verified); and

50.3.11.3 the extent to which Variations are part of the original requirement (for example, with training and simulator projects where changes are inevitable, whereas in many accommodation projects they can often be avoided).

50.4 **Means of Payment**

50.4.1 The Institution Variation may require Capital Expenditure that will have the effect of increasing the Private Party's financing costs (for example, due to further construction work to be performed in the construction phase). In that case, the Institution should meet such costs by payment of a lump-sum, staged payments or sums to pay for the reasonable costs of the Private Party as they are incurred (on presentation of invoices), unless the Private Party is able to fund the costs itself and amortise them through the period of the PPP Agreement through an increase in the Unitary

Payment in a way that is value for money.[316] The Private Party should not receive payment in full before it has fully implemented the necessary Variation.

50.4.2 Any increase in operating costs resulting from an Institution Variation should normally be met by an increase in Unitary Payment. Again, the Parties should decide whether the increase is best paid in a lump-sum or by increases in some or all periodic Unitary Payments.

50.4.3 If the Variation will reduce the Private Party's costs (whether Capital Expenditure or operating costs), then an appropriate reduction should be made to the Unitary Payment or the user charges that will apply (taking into account the fact that the Private Party's financial position should neither be benefited nor prejudiced). In the case of lower Capital Expenditure, the effect will be to reduce the amount of committed funding required by the Private Party.

Standard Clause

Institution Variations[317]

(a) The Institution has the right to propose Variations to the Project Deliverables in accordance with this Clause. The Institution shall not propose a Variation which [x].[318] *If the Institution requires a Variation to the Project Deliverables, it must serve a notice on the Private Party detailing the requested Variation (an "**Institution Variation Proposal**").*

(b) The Institution Variation Proposal shall:

*(i) set out the Variation required in sufficient detail as to enable the Private Party to calculate and provide the estimated revised Project costs in accordance with Clause (c) below (the "**Estimate**");*

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316 This may not be possible in projects where the revenue system is based on a user charge (see Part J:46 (*Relief Events*), Part J:47 (*Compensation Events*) and Part J:48 (*Force Majeure*)).

317 The suggested approach is for (where possible) a lump-sum payment to be made for a Compensation Event with no obligation being imposed on the Private Party to seek additional funding.

318 Limits on the Institution's ability to request variations to the Project Deliverables may be appropriate in some circumstances. This will depend on the Project, but there will be a point at which what is proposed is no longer the same service (or incidental or ancillary to it) and the Institution should have no difficulty with the principle of limiting its ability to suggest changes in this way. Examples of appropriate limits include, in general terms: (i) Variations which require the Services to be performed in a way that infringes any law or is inconsistent with Good Industry Practice; (ii) Variations which would cause any Consent to be revoked (or be unobtainable); (iii) Variations which would, if implemented, result in a change in the nature of the Project (for example, as a prison or hospital); and (iv) Variations which would materially and adversely affect the Services in a way that is not compensated for.

(ii) *require the Private Party to provide the Institution within [x] Business Days of receipt of the Institution Variation Proposal, with the Estimate.*

(c) *As soon as practicable and in any event within [x] Business Days after having received the Institution Variation Proposal, the Private Party shall, subject to Clause (h) deliver the Estimate to the Institution. The Estimate shall include the opinion of the Private Party on:* [319]

(i) *whether relief from compliance with its obligations is required, including the obligations of the Private Party to achieve the Scheduled Service Commencement Date and meet the [performance regime] during the implementation of the Variation:*

(ii) *any impact on the Scheduled Service Commencement Date;*

(iii) *any impact on the provision of the Services;*

(iv) *any amendment required to this PPP Agreement and/or any Project Document as a result of the Variation;*

(v) *any estimated revised Project costs*[320] *that result directly from the Variation;*

(vi) *any loss of revenue that will result directly from the Variation;*

(vii) *any Capital Expenditure that is required or no longer required as a result of the Variation;*

(viii) *any regulatory approvals which are required; and*

(ix) *the proposed method of certification of any Works or operational aspects of the Variations required by the Institution Variation Proposal if not covered by the procedures specified in Clause [x] [the Services Commencement Clause].*

(d) *As soon as practicable after the Institution receives the Estimate, the Parties shall discuss and agree the issues set out in the Estimate. The Private Party shall:*

(i) *provide evidence that it has used reasonable endeavours (including (where practicable) the use of competitive quotes) to oblige its Subcontractors to*

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[319] Other information may be needed depending on the Project.

[320] This Estimate should take into account any previously budgeted capital costs which will no longer be incurred due to the Variation (for example, if a new type of roof is needed during the construction phase, that could potentially result in lower maintenance costs). The costs should also be broken down in accordance with a pre-agreed framework so that sufficient transparency exists (see Part J:46 (*Relief Events*), Part J:47 (*Compensation Events*) and Part J:48 (*Force Majeure*)).

minimise any increase in costs and maximise any reduction in costs;

(ii) *demonstrate how any Capital Expenditure to be incurred or avoided is being measured in a cost-effective manner; and*

(iii) *demonstrate that any expenditure that has been avoided, which was anticipated to be incurred to replace or maintain assets that have been affected by the Institution Variation concerned, has been taken into account in the amount which in its opinion has resulted or is required under Clauses (c) (iv) and/or (v) above.*

In such discussions the Institution may modify the Institution Variation Proposal and (if the estimated increase in Capital Expenditure in respect of the Variation is expected to exceed [R] (indexed to [CPIX]) and it is practicable for the Private Party to do so), the Institution may require the Private Party to seek and evaluate competitive tenders for the relevant capital works. In each case the Private Party shall, as soon as practicable, and in any event not more than [x] days after receipt of such modification, notify the Institution of any consequential changes to the Estimate.

(e) *The Private Party shall comply with Good Industry Practice with the objective of ensuring that it obtains best value for money (taking into account all relevant circumstances including, in particular, the requirement that the Private Party should not be worse off as a result of the implementation of the Variation) when procuring any work, supplies, materials or equipment required in relation to the Variation.*

(f) *If the Parties cannot agree on the contents of the Estimate, then the dispute will be determined in accordance with Clause [x] (Fast-track Dispute Resolution).*

(g) *As soon as practicable after the contents of the Estimate have been agreed or otherwise determined pursuant to Clause [x] (Fast-track Dispute Resolution), the Institution shall:*

(i) *confirm the Estimate (as modified) in writing; or*

(ii) *withdraw the Institution Variation Proposal.*

(h) *Notwithstanding the other provisions of this Clause [x]:*[321]

(i) *if, on receipt of the Institution Variation Proposal pursuant to Clause (a), the Private Party is of the opinion that such Variation is likely to result in an increase in the Project risk or its financial risk or to generally adversely affect the risk profile of the Private*

[321] This must refer to the entire clause.

Party, it shall, as soon as practical and in any event within [x] Business Days after having received the Institution Variation Proposal, serve a notice on the Institution stating its opinion and the reasons therefor; and

(ii) *the Parties shall meet as soon as practical and in any event within [x] Business Days of receipt of such notice. If the Parties agree that such Variation is likely to increase the Project risk or the Private Party's financial risk or to generally adversely affect the risk profile of the Private Party, the Institution Variation Proposal shall be withdrawn. If the Parties are unable to agree on the likely effects of the Institution Variation Proposal, either Party may refer the matter to [Independent Expert] pursuant to Clause [x] (Fast-track Dispute Resolution). If it is determined by [Independent Expert] that the Institution Variation Proposal will increase the Project risk, financial risk or generally adversely affect the risk profile of the Private Party, the Institution Variation Proposal shall be deemed to have been withdrawn.*

(i) *If the Institution does not confirm the Estimate (as modified) in writing within [x] days of the contents of the Estimate having been agreed in accordance with Clause (d) or determined pursuant to Clause (f), then the Institution Variation Proposal shall be deemed to have been withdrawn.*

(j) *In the event that the Estimate (as modified) involves estimated Capital Expenditure[322] then the Private Party shall use its reasonable endeavours to obtain funding for the whole of the estimated Capital Expenditure, on terms reasonably satisfactory to it and the Institution.*

(k) *If the Private Party has used its reasonable endeavours to obtain funding for the whole of the estimated Capital Expenditure, but has been unable to obtain an offer of funding within [x] Business Days of the date that the Institution confirmed the Estimate, then the Private Party shall have no obligation to carry out the Variation, unless the Institution agrees to pay the costs involved.*

(l) *The Institution may, at any time following the date on which the Estimate is confirmed, agree to meet all or, to the extent the Private Party has obtained funding for only part of the Capital Expenditure, the remaining part of the Capital Expenditure.*

322 It may be appropriate to introduce a threshold on the estimated increased Capital Expenditure below which it is not necessary for the Private Party to seek to obtain funding. This should ensure that the Private Party is not required to go through the effort of arranging funding for relatively immaterial sums. Any such threshold should, however, be increased annually in line with CPIX.

(m) *In the event that the Estimate has been confirmed by the Institution,*[323] *then the Unitary Payment shall be adjusted in accordance with the Estimate.*[324]

(n) *Where the Institution agrees to pay the costs for which funding is not available pursuant to Clause (k) above:*

(i) *the Institution and Private Party shall agree:*

(aa) *a payment schedule in respect of the payment of such sum reflecting the amount and timing of the costs to be incurred by the Private Party in carrying out the Variation to the extent borne by the Institution; and*

(bb) *where payment for part of the Variation reflects the carrying out of, or specific progress towards, an element within the Variation, an objective means of providing evidence confirming that the part of the Variation corresponding to each occasion when payment is due under the payment schedule appears to have been duly carried out,*

(such payment schedule and evidence to be determined by [Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution) in the event of the Institution and Private Party failing to agree as to its terms);

(ii) *the Institution shall make payment to the Private Party within [x] Business Days of receipt by the Institution of Invoices presented in accordance with the agreed payment schedule (as the case may be, varied by agreement from time to time) accompanied by the relevant evidence (where applicable) that the relevant part of the Variation has been carried out; and*

(iii) *if payment is not made in accordance with sub-Clause (n)(ii) above, the Institution shall pay interest to the Private Party on the amount unpaid from the date [x] Business Days after receipt of the relevant Invoice until paid, at the Default Interest Rate.*

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[323] If the Institution Variation simply has a cost consequence (and no change is made either in the timetable for completion or increase in costs of operation), then it can be dealt with as a one-off payment without an adjustment to the Unitary Payment or timetable.

[324] The adjustment to the Unitary Payment would take account of any increased operational costs of the Private Party and any increased capital costs funded by the Private Party. Any increased capital costs funded by the Institution or loss of revenue caused by the Institution Variation should be paid to the Private Party by way of direct payments from the Institution and not through an increase in the Unitary Payment. To the extent that the Institution Variation will prevent the Private Party from making the Services available, the Private Party should be relieved from the accrual of Penalty Deductions.

50.5 Small Works Variations

50.5.1 To facilitate efficient management of the PPP Agreement, reduce costs for both Parties and ensure continued delivery of the Services, the PPP Agreement should provide an efficient mechanism for dealing with requests by the Institution for small Variations to the Works. The small works procedure should only be used for the purposes of requiring additional capital works. Due to the complexity of requiring Variations to the Services element, the Private Party will not be able to provide the Institution with annual rates relating to such Variations, and such Variations will need to be requested in accordance with Section 50 (*Variations*).

50.5.2 In any PPP Agreement year the Institution may have to make several requests to the Private Party in respect of minor Variations to the Works. Provided that the threshold is sufficiently low for the Private Party to manage, there is no reason why the Private Party should not be able to provide a schedule of rates to the Institution at the beginning of each PPP Agreement year, which, (when agreed) shall apply in respect of all requests from the Institution for small Works Variations to be implemented by the Private Party. The Private Party should provide the Institution with a rate in respect of labour costs, while the materials element of any small Works Variations should be charged at cost plus a pre-agreed margin. The Institution should reimburse the Private Party for small Works Variations in accordance with these rates.

Standard Definition

*"**Small Works**" means any change*[325] *to the Works requested by the Institution having an individual cost not exceeding [R] (indexed to [CPIX]), or as otherwise agreed from time to time, except for any request which will (if implemented) increase the likelihood of the Services not complying with the [performance regime]*[326] *or materially and adversely affect the Private Party's ability to perform its obligations under this PPP Agreement.*

[325] Small works are not intended to cover works that require specialist labour that the Private Party or its Subcontractors are unable to perform.

[326] This is the regime in terms of which Penalty Deductions are calculated.

Standard Clause

Small Works Variations

(a) *At least [x] days prior to the Scheduled Service Commencement Date and the commencement of each subsequent PPP Agreement year, the Private Party shall propose a schedule of rates to be agreed with the Institution (the "**Small Works Rates**"), such agreed rates to be applied in respect of any request from the Institution for Small Works to be completed during that PPP Agreement year. The value of any Small Works shall be calculated on the basis that:*

(i) *the labour element shall be calculated in accordance with the Small Works Rates or, where such rates are not applicable, in accordance with rates which are fair and reasonable; and*

(ii) *the materials element shall be charged at the cost of the materials to the Private Party or to the party carrying out the work (net of all discounts) plus [x]%.*[327]

(b) *The Institution shall pay the Private Party for the costs of Small Works Variations in accordance with the Small Works Rates.*

(c) *The Private Party and the Institution shall agree the timing of any Small Works, so as to minimise any inconvenience to the Institution. The Private Party shall take all reasonable steps to minimise the duration of any Small Works.*

(d) *Any dispute between the Parties relating to Small Works shall be determined by [Independent Expert] in accordance with Clause [x] (Fast-track Dispute Resolution).*

50.6 **Private Party Variations**

50.6.1 The Institution should generally not be concerned with the means by which the Services are made available and should not normally object to any Variation in such means. The Private Party should be encouraged to find ways of making the Services available more cheaply and efficiently.

50.6.2 It may, however, be appropriate for the Institution to reserve the right to object to certain Variations in the means of delivery.[328] In such cases, a procedure should be built into the PPP Agreement providing for the Private Party to serve a Private Party Variation Proposal (including any

[327] To be determined on a project-by-project basis.

[328] This may be the case, for example, if the Private Party's proposed Variation will adversely affect the Institution's ability to perform any retained activities (such as clinical services in a hospital).

consequential amendments required to the PPP Agreement and other Project Documents) on the Institution, giving the Institution an opportunity to object on reasonable grounds within a reasonable time period. If the Institution objects, the Private Party Variation Proposal should not be made or should be amended and presented again.

50.6.3 In all PPP Agreements, however, the Institution will need a similar procedure to be followed if the Private Party proposes a Variation to the Services, although in this case the Institution should not be under any obligation to give reasons for any refusal to agree to a change.

50.6.4 The Institution should generally object only if the primary tenets of the PPP Agreement are likely to be compromised. This might be the case if:

50.6.4.1 the Variation will not provide the Institution with the Services it requires;

50.6.4.2 the Variation diminishes the quality of the Services to be delivered by the Private Party or the likelihood of successful delivery;

50.6.4.3 the Variation will interfere with the Institution's relationship with third parties;

50.6.4.4 the Variation threatens the Private Party's financial robustness;

50.6.4.5 the residual value of the Project assets is likely to be materially reduced (see Part N:62 (*Termination: Handback*)); or

50.6.4.6 the Variation materially affects the risks or costs to which the Institution is exposed.

50.6.5 A Private Party Variation Proposal will not normally be expected to result in an increase in the Unitary Payments but should allow the same Services to be made available more cheaply (so improving the return on Equity of the Private Party); improved Services to be made available at the same price; or a combination of the two. If the Private Party's costs will be reduced by the Private Party Variation Proposal, a reduction in the

Unitary Payments can be agreed as part of the procedure. The benefits could be shared between the Parties by increasing the quality and/or scope of the Services.

Standard Clause

Private Party Variations

(a) *If the Private Party wishes to introduce a Variation,*[329] *it must serve a notice on the Institution providing details of such Variation (a "**Private Party Variation Proposal**").*

(b) *The Private Party Variation Proposal must:*

(i) *set out the proposed Variation in sufficient detail to enable the Institution to evaluate it in full;*

(ii) *specify the Private Party's reasons for the Private Party Variation Proposal;*

(iii) *request the Institution to consult with the Private Party with a view to deciding whether to agree to the Private Party Variation Proposal and, if so, what consequential changes the Institution requires as a result;*

(iv) *specify all implications of the Private Party Variation Proposal on this PPP Agreement and any of its terms;*[330]

(v) *indicate, in particular, whether a Variation to the Unitary Payments is proposed (and, if so, give a detailed cost estimate of such proposed Variation); and*

(vi) *indicate if there are any dates by which a decision by the Institution is critical.*

(c) *The Institution shall evaluate the Private Party's Variation Proposal taking into account all relevant issues, including whether:*

(i) *a change in the Unitary Payments will occur;*

(ii) *the Variation will affect the quality or successful delivery of the Services;*

(iii) *the Variation will interfere with the relationship of the Institution with third parties;*

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[329] It is likely that a Variation in the means of delivery will, for the purposes of the PPP Agreement, result in a Variation to the Services.

[330] For example, the contractual, financial, operational and/or construction implications of the Variation in Services.

(iv) *the financial strength of the Private Party is sufficient to perform the Variation;*

(v) *[the residual value of the Project Assets is reduced];*[331] *and*

(vi) *the Variation materially affects the risks or costs to which the Institution is exposed.*

(d) *As soon as practicable after receiving the Private Party Variation Proposal, the Parties shall meet and discuss the matters referred to in it. During their discussions the Institution may propose modifications or accept or reject the Private Party Variation Proposal.*

(e) *If the Institution accepts the Private Party Variation Proposal (with or without modification), the Private Party shall begin to implement the relevant changes arising from the Variation within [x] Business Days of the Institution's acceptance.*[332] *Within this period, the Parties shall consult and agree the remaining details as soon as practicable and shall enter into any documents to amend this PPP Agreement or any relevant Project Document, which are necessary to give effect to the Variation.*

(f) *If the Institution rejects the Private Party Variation Proposal, it shall not be obliged to give its reasons for such a rejection.*

(g) *Unless the Institution's acceptance specifically agrees to an increase in the Unitary Payments, there shall be no increase in the Unitary Payments as a result of that accepted Variation.*

(h) *If the Private Party Variation Proposal causes or will cause the Private Party's costs or those of a Subcontractor to decrease, there shall be a decrease in the Unitary Payments such that [x].*[333]

[331] This will be relevant in projects in which the Institution bears all or part of this risk.

[332] This means that all aspects of the Variation must be agreed prior to implementation, including the availability of funding where appropriate.

[333] A mechanism should be agreed to the effect that any savings are shared, having deducted from any savings the costs which the Private Party has incurred in implementing the Variation.

PART L: EMPLOYMENT

51 EMPLOYEES

51.1 Section 197 Transfers

51.1.1 If a PPP involves the transfer or partial transfer of the existing operations of an Institution, then the interests of the employees employed in those operations must be considered, particularly in light of section 197 of the Labour Relations Act, 1995, which applies when a business, trade or undertaking is transferred as a *going concern*.

51.1.2 Section 197 provides for the automatic transfer of the contractual rights and obligations of employees employed in a going concern from the transferor to the transferee. The transferee then becomes the employer and inherits the transferor's employment liabilities in respect of the transferring employees, including its liability for all unpaid salaries, wages and benefits that have accrued in the period up to the transfer of the going concern.

51.1.3 Whether or not section 197 will apply to the Institution's employees in a PPP involving the transfer of existing operations to a Private Party depends on whether such operations constitute a going concern for the purposes of that section. The legal meaning of the term "going concern" depends on the circumstances surrounding each transfer and, accordingly, the Institution will have to obtain legal advice about the section 197 status of the employees employed in the transferring operations.

51.1.4 Because of the protections afforded to transferring employees by section 197 (that is, as between the employees and the transferee), Institutions who wish to transfer their employees to the Private Party should consider doing so, as if section 197 were applicable, even in circumstances where section 197 might not apply. However, the Institution should bear in mind that the bidders are likely to levy a substantial premium for taking transfer of employees on a section 197 basis. Bid prices will reflect the value of unpaid accrued pre-transfer liabilities in respect of salaries, wages and benefits. Furthermore, given that the value of certain benefits, particularly pension benefits, may be an actuarial (as opposed to actual) value, the bid prices may also reflect substantial contingencies to cover potential inaccuracies in the calculation of these values.

51.1.5 Where employees are transferred and section 197 is not applicable (even though the Parties may have agreed that the transfer will be treated "as if" section 197 were applicable), the prior consent of each employee will be required for his/her transfer. Where section 197 applies, the consent of a transferring employee is required to the extent that the terms and conditions of his/her employment will change on transfer. Institutions should be aware, however, that such changes may be unavoidable where employees transfer from the public sector to the private sector because the private sector may not be able to provide the same or equivalent benefits as the public sector. So it is likely that even where section 197 applies to a PPP, the Institution will need to obtain the consents of the transferring employees as the terms and conditions of their employment may change.

51.1.6 The Institution should commence consultations with affected employees (and their trade unions) regarding their proposed transfer well in advance of the procurement phase of the Project to establish who among them wish to transfer to the Private Party and to ensure a smooth transfer process. To assist employees in this process, the Institution should (at its cost) appoint independent financial and tax advisors to advise employees regarding the transfer. It is important to ensure that, where any pension benefits may be paid out to transferring employees on transfer, these employees have access to such financial and tax advisors.[334]

[334] See Section 52 (*Pension Benefits*).

51.2 **Basic Transfer Principles**

In a PPP involving the transfer of employees by the Institution, the following basic principles should be followed:

51.2.1 the Private Party must be substituted in the place of the Institution in respect of all contracts of employment relating to those employees;

51.2.2 the transfer does not interrupt any such employee's continuity of employment and his/her contract of employment continues with the Private Party as if with the Institution;

51.2.3 all unpaid salaries, wages and benefits (including accumulated leave, pension benefits, post-retirement medical aid benefits, and so forth) that have accrued in the pre-transfer period should be independently valued. This independent valuation should also extend to unpaid employee liabilities (such as study loans and housing loans) that have accrued in the pre-transfer period;

51.2.4 the Institution should indemnify the Private Party in respect of any claim by a transferring employee for unpaid accrued pre-transfer employment liabilities that have not been taken into account in the valuation, if such indemnity will provide better value for money. Any such indemnity should be subject to the limitations mentioned in Part C:9 (*General Obligations: Indemnities and Claims for Damages*);[335] and

51.2.5 as between the Private Party and the Institution:

51.2.5.1 the Institution should assume no liability in respect of any employment liabilities that will accrue in the post-transfer period; and

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[335] The indemnity and particularly any limitations on it will be a heavily debated issue. The Private Party and its funders will not want to assume any liability for the benefits and rights of employees accrued in the pre-transfer period because these will usually be very substantial and sometimes difficult to quantify in light of the nature of the benefits enjoyed by public sector employees (which are generally not matched in the private sector). For example, many public sector employees are members of defined benefit pension schemes rather than defined contribution schemes (as in the private sector). Defined benefits accrue regardless of the performance of the fund.

51.2.5.2 the Institution's liability in relation to the transferring employees should not exceed the unpaid employment liabilities that have accrued in the pre-transfer period.

51.3 **Control of Employee Conduct**

51.3.1 Subject to all applicable labour laws as amended from time to time, the Institution may reserve for itself the right to instruct the Private Party to take appropriate disciplinary action, or ensure that such action is taken, against employees of the Private Party if there are reasonable grounds for such action. This need for control applies both to the performance of the Private Party's employees and to any Subcontractors (and their employees).

51.3.2 Although it may appear undesirable for the Institution to have such control, there may be sound reasons for this, for example, public health, public safety or national security.

51.3.3 Because such controls will have cost implications, the Institution must disclose its control requirements in the RFP and they must be included in the PPP Agreement. The Private Party's employment policies will need to reflect the Institution's requirements which may entail that the Private Party consult with the employees on a broader basis.

Standard Clause

<u>Key Personnel and Removal of Personnel</u>

(a) The Private Party shall at all times ensure that sufficient suitable and appropriately qualified and experienced personnel will be employed (whether by the Private Party or its Subcontractors) to undertake the Project Deliverables and that such personnel shall be located in the Republic of South Africa. Without limiting the generality of the foregoing, the Private Party shall ensure that all key personnel positions are always filled as soon as reasonably possible.

(b) The Institution may require the Private Party to remove any employee or other personnel of the Private Party or any Subcontractor from the Project Site and the Private Party shall do so (provided such removal is permitted under applicable law) if in the reasonable opinion of the Institution such employee or personnel engages in any conduct which might reasonably result in

a breach of any provision of this PPP Agreement or threaten public health, safety or security, and the Private Party shall as soon as reasonably possible replace such employee or personnel with suitable appropriately qualified and experienced replacements (provided such replacement is permitted under applicable law).

52 PENSION BENEFITS

52.1 Section 197 provides for the continuity of employment as between the new employer and the transferring employees but it does not automatically "guarantee" the *same* pension benefits (given that this is dependent on the relationship between the pension fund and the member, which is determined by the rules of the pension fund). Section 197 also does not automatically "guarantee" the transferability of the accrued pre-transfer pension benefits from the pension funds of the old employer to the funds of the new employer.

52.2 In the circumstances, each type of benefit to be transferred needs to be assessed in detail to ensure that the employees are placed in substantially the same position in terms of benefits pursuant to their employment with the Private Party. This is important since certain benefits offered by various Institutions may not be matched by benefits available in the private sector. Examples in this regard are particular "State-funded" benefits such as post-retirement medical aid benefits.[336]

52.3 Institutions should also be aware that the rules governing some pension funds may not expressly cover the situation where employees are transferred on a section 197 basis and may effectively require that the transferring employees be treated as having been retrenched or otherwise dismissed, with the result that their accrued pension benefits must be paid out to them on transfer and may not be transferred from the old employer to the new employer.[337] The Private Party will usually expect the Institution to procure that these benefits are paid out by the pension funds in full on transfer.

[336] See also footnote 335.

[337] The rules of these types of funds typically also preclude the transferring employees from retaining their membership once the transfer becomes effective.

52.4 In light of the above, Institutions must undertake a thorough review of the rules of their pension funds to establish whether or not accrued pre-transfer pension benefits may be transferred to the Private Party's retirement funds. The results of this review must be included in the feasibility study accompanying the Institution's application for TA:I.

52.5 If the review establishes that the pension fund rules may restrict or bring about unintended consequences for the transfer of the employees, then the Institution should engage with the trustees or administrators of the pension fund, the employees and their trade unions regarding appropriate amendments to the rules.[338]

53 TRAINING

53.1 The PPP Agreement must incorporate the Private Party's undertakings in its bid documents (as improved on in the negotiation phase) with regard to the ongoing training of employees.[339]

53.2 The Private Party will also be required to undertake and ensure that, at all times, there is a sufficient number of staff employed and that the Project Deliverables are carried out with the requisite level of skill and experience. The obligation extends over periods of vacation, sickness and other absence and must provide for such training and supervision as is necessary to ensure that all employees, whether permanent or replacement employees, who are expected to use or operate any equipment, receive adequate and ongoing training to ensure that there is proper performance in terms of the PPP Agreement. A critical component of the training[340] is to ensure compliance with all health and safety rules, procedures and requirements in respect of the Project Assets.

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[338] Institutions should be aware that some transferring employees might prefer to be paid out on transfer. The risk here is that these employees may spend all their pension benefits well before retirement. This is partly why it is so essential for Institutions to ensure that employees have access to independent financial and tax advisors. See Section 51.1.6 above.

[339] See Part M:57 (*Black Economic Empowerment: Private Party Management and Employment Equity*).

[340] In IT projects information security training is also important.

54 PROJECT SITE SAFETY AND SECURITY

54.1 The Private Party should set up and maintain policies and procedures covering all matters relevant to the Project including, without limitation, discipline, grievance, equal opportunities and health and safety.

54.2 In circumstances where the Parties have shared access to the Project Site or Facilities (for example, a hospital project), the PPP Agreement should specifically retain for the Institution the right to refuse admittance to, or to remove from, the Facilities any person employed by the Private Party or any Subcontractor whose presence in the reasonable opinion of the Institution is likely to have a material adverse effect on the performance by the Institution of its statutory duties or poses a serious threat to the health or safety of others. A procedure needs to be agreed to give the Institution the requisite authority.

PART M: BLACK ECONOMIC EMPOWERMENT

55 GENERAL

55.1 Definitions

The following definitions are prescribed for use in the PPP Agreement.

Standard Definitions

*"**Active Equity**" means, in relation to any Black Equity [and any issued shares in the share capital of any Subcontractor held by Black People and/or Black Enterprises], that such Black Equity is [or shares are] held by Black People and/or Black Enterprises who will participate directly in the day-to-day management and operations of the Project on the terms described in Schedule [x];*[341]

*"**Annual BEE Report**" has the meaning set forth in Clause [x]*[342]*;*

*"**Annual Skills Development Commitment**" has the meaning set forth in Clause [x]*[343]*;*

*"**Black Enterprise**" means an enterprise that is at least 50.1% beneficially owned by Black People and in which Black People have substantial Management Control. Such beneficial ownership may be held directly or through other Black Enterprises;*

*"**Black Equity**" means the voting Equity held by Black Shareholders from time to time;*[344]

*"**Black People**" means African, Coloured and Indian South African citizens, and "**Black Person**" means any such citizen;*

*"**Black Shareholder**" means any Shareholder that is a Black Person or a Black Enterprise;*[345]

*"**Black Women**" means female African, Coloured and Indian South African citizens*;

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341 If there is no requirement for any portion of the equity held by Black People and/or Black Enterprises at the Subcontractor level to be held as Active Equity, then the bracketed wording in this Standard Definition must be deleted.

342 This is a reference to the Standard Clause in Section 56 (*Black Equity in the Private Party*).

343 This is a reference to (c) in the Standard Clause in Section 57 (*Private Party Management and Employment Equity*).

344 This term covers all Equity *in the Private Party* held by Black People and/or Black Enterprises, and not the equity in the Subcontractors or second-tier subcontractors held by Black People and/or Black Enterprises.

345 This term covers all those Shareholders *in the Private Party* who are Black People and/or Black Enterprises, not the shareholders of the Subcontractors or second-tier subcontractors who are Black People and/or Black Enterprises.

*"**Management Control**" means, in relation to any enterprise, the ability to direct or cause the direction of the business and management policies or practices of that enterprise;*

*"**Minimum Black Equity**" has the meaning set forth in Clause [x]*[346]*; and*

*"**SMME**" or "**Small, Medium or Micro Enterprise**" means any business, trade, undertaking or other enterprise which is directly owned and managed by one or more natural persons and which has:*

(a) less than [x] full-time employees;

(b) an annual turnover less than [Rx] (indexed to [CPIX]); and

(c) gross asset value (fixed property included) of less than [Rx] (indexed to [CPIX]).[347]

55.2 **Broad-based Black Economic Empowerment**

55.2.1 It is the government's intention that PPPs provide a showcase for its strategy for broad-based black economic empowerment ("**BEE**").

55.2.2 The government's policy objectives for BEE are contained in the Code of Good Practice for Black Economic Empowerment in Public Private Partnerships, 2004[348] issued by the Minister for Trade and Industry pursuant to the Broad-based Black Economic Empowerment Act, 2004 (the "**BBBEE Act**"). They include:

55.2.2.1 direct beneficial ownership by Black People of Equity in the Private Party;

55.2.2.2 direct participation by Black People (especially Black Women) in the Management Control of the Private Party and the Subcontractors, and in the day-to-day management and operation of the Project;

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[346] This is a reference to the Standard Clause in Section 56 (*Black Equity in the Private Party*) and refers to the minimum shareholding for Black Shareholders *in the Private Party*, not a minimum shareholding for Black People and/or Black Enterprises in the Subcontractors. This Standardisation does not prescribe a minimum *equity* participation for Black People and/or Black Enterprises in the Subcontractors or the second-tier subcontractors.

[347] The number of employees and Rand amounts must be determined on a project-by-project basis. Depending on the nature of the Project, it may also be necessary to specify different numbers and amounts for certain business sectors or sub-sectors (thus, compare construction and/or manufacturing, on the one hand, with "soft" services such as catering, facilities management and the like). These determinations must be made during the feasibility study phase and stipulated in the RFP, taking account of any relevant sector-specific charters issued in terms of the Broad-based Black Economic Empowerment Act, 2004.

[348] Module 2: Code of Good Practice for BEE in PPPs.

55.2.2.3 direct participation by Black People and Black Enterprises in the subcontracting arrangements and the procurement requirements of the Private Party and the Subcontractors;

55.2.2.4 skills development opportunities for Black People employed in connection with the Project whether at the Private Party or Subcontractor level and the realisation of employment equity targets; and

55.2.2.5 beneficial socio-economic impacts at local community level (for the benefit of SMMEs, the youth, the disabled, non-profit organisations and so forth).

55.3 **Empowerment Monitoring and Penalties**

55.3.1 Generally, the monitoring of the implementation of the Private Party's empowerment commitments in the PPP Agreement will be covered by the overall monitoring regime for the PPP Agreement, which must include a substantial element of self-monitoring and reporting by the Private Party, subject to periodic review by the Institution. This monitoring regime involves the collection and evaluation of availability and performance data that will provide the foundation for Penalty Deductions for failures to meet the output specifications.

55.3.2 The payment mechanism for Penalty Deductions, however, is geared towards the unavailability of the Services and poor performance, and may thus not fully address failures to meet or maintain BEE targets.

55.3.3 Accordingly, it is likely that the specific empowerment monitoring regime and empowerment penalty regime will need to be tailored to deal with failures to meet or maintain BEE targets, although these regimes will still need to link into and be consistent with the overall payment mechanism provided for in the PPP Agreement. In particular, the empowerment monitoring regime will need to reflect the connection between the empowerment data collected and evaluated under that regime, and the empowerment penalties. The empowerment penalty regime, in turn, will need to reflect the connection between the empowerment penalties and the overall payment mechanism in the PPP Agreement.

55.3.4 Empowerment monitoring must at least occur at the following levels:[349]

55.3.4.1 systematic self-monitoring by the Private Party at scheduled intervals through a quantative and qualitative monitoring system measuring specified BEE targets. This system must provide for the collection and recording of specified empowerment data (for example, Black Equity data (and, if in a specific project there is a requirement for equity holdings by Black People and/or Black Enterprises in any Subcontractor, then also such equity data), management appointment data, employment equity data, and so forth) in a pre-agreed format; and

55.3.4.2 reviews of the monitoring system by the Institution at scheduled intervals and randomly (that is, “spot checks”) and reviews of the BEE reports and records required to be produced by the Private Party, with the Institution having the right to increase its reviews when failures to meet or maintain BEE targets occur.

55.3.5 In addition, the PPP Agreement may provide for reviews by independent monitors.

55.3.6 Institutions should bear in mind that the successful implementation of the empowerment monitoring regime and penalty regime is dependent on how well their BEE targets are established during the feasibility study phase,[350] and articulated in their RFP documents[351] and their PPP Agreements. Accordingly, Institutions must ensure that the BEE

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[349] Although a Standard Clause regarding the periodic reporting by the Private Party of information concerning changes in the Black Equity from time to time is included in this Standardisation, this Standard Clause only addresses a narrow aspect of the empowerment monitoring regime. Accordingly, Institutions will have to ensure that provisions dealing with the overall empowerment monitoring regime (including the link-up to the empowerment penalties and overall payment mechanism for the PPP Agreement) are included in the PPP Agreement. In this regard, Institutions should bear in mind that the nature and scope of the empowerment monitoring regime depends on the general monitoring regime, which is in turn dependent on the nature of the payment mechanism for the PPP Agreement.

[350] Refer to Module 4: PPP Feasibility Study.

[351] Refer to Module 5: PPP Procurement.

targets are stated in all these documents in precise, measurable and quantifiable terms.

55.3.7 The empowerment monitoring regime set out in the PPP Agreement must be consistent with the Institution's statutory monitoring obligations. In this regard, the Institution should bear in mind that Treasury Regulation 16.7.1 obliges accounting officers and accounting authorities to maintain mechanisms and procedures for measuring and monitoring all outputs (including BEE targets) provided for in the PPP Agreement. These mechanisms and procedures must be set out in the contract management plan that must accompany the final agreed draft PPP Agreement submitted for Treasury Approval (that is, TA:III).

55.4 **Non-compliance with BEE Targets**

55.4.1 Non-compliance by the Private Party with its BEE commitments (including any failure to meet agreed BEE targets within the agreed timeline) should not result in the immediate termination of the PPP Agreement. Instead the Private Party should first be given an opportunity to remedy such non-compliance, failing which the PPP Agreement may be terminated for Private Party Default.[352]

55.4.2 During the Service Period, non-compliance by the Private Party with its empowerment commitments may also be dealt with through the levying of deductions to be made against the Unitary Payments, in the form of empowerment penalties.[353]

56 BLACK EQUITY IN THE PRIVATE PARTY

56.1 The PPP Agreement must incorporate the requirements of the Institution in relation to the Black Equity and the participation by the Black Shareholders in

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[352] See Part N:60.3 (*Termination: Termination for Private Party Default*) and Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*).

[353] No Standard Clause is included in this Standardisation for the empowerment penalty regime and accordingly appropriate clauses will need to be developed for each PPP Agreement. This is because the choice of empowerment penalty regime depends on the overall payment mechanism chosen for the PPP Agreement, which is to be determined on a project-by-project basis because it is linked to the nature and scope of the output specifications. The bidders will be asked to bid on their preferred monitoring regime and payment mechanism (including the empowerment monitoring and penalty regimes), and these will have to be evaluated by the Institution in the bid evaluation phase.

the day-to-day management and operation of the Private Party as set out in the RFP, plus any additional commitments made by the Private Party in respect of these BEE targets. At a minimum it must reflect the principles set out below.

56.2 A minimum percentage[354] of the voting Equity of the Private Party from time to time must be allocated for direct beneficial ownership by Black People and/or Black Enterprises.

56.3 This Black Equity must be "locked-in" for a specified period,[355] allowing for the whole or part of it to be transferred by the Black Shareholder(s) only to other Black Shareholders, Black People and/or Black Enterprises during that period.[356] If the initial minimum Black Equity allocation is low, provision may be made for the ramp-up of this allocation over the Project Term.

56.4 A specified proportion[357] of this minimum Black Equity must be held as Active Equity (that is, not as "pure investment" equity). The nature of this Active Equity participation must be determined on a project-by-project basis and set out in the PPP Agreement in precise, measurable and quantifiable terms to ensure that it can be effectively monitored.

56.5 The Financial Model incorporated in the PPP Agreement must reflect the agreement of the Parties regarding the early[358] participation by the Black Shareholders in the cash flows of the Project. How such participation ought to be structured is not prescribed in this Standardisation. Each Institution has the flexibility to agree a structure that will achieve its minimum targets for cash flow participation, without compromising the affordability levels and value for money benefits required for the Project.

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[354] The Institution must establish this percentage on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This percentage must be stipulated in the RFP.

[355] The Institution must establish the appropriate lock-in period on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This period must be stipulated in the RFP.

[356] See Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*).

[357] The Institution must establish this proportion on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This proportion must be stipulated in the RFP.

[358] The Shareholders are always last in line to participate in the cash flows generated in PPPs funded on a project finance basis. This is particularly debilitating for the Black Shareholders that are newly formed Black Enterprises or in need of ready access to cash.

Standard Clause

Black Equity in the Private Party

The Private Party shall ensure that:

*(a) for [period], no less than [x] percent of the voting Equity from time to time shall be directly and beneficially owned by Black People and/or Black Enterprises (the "**Minimum Black Equity**")*[359] *and such Equity shall rank pari passu with the voting Equity held by the Shareholders who are not Black People or Black Enterprises;*

(b) for [period], no less than [x] percent of the Black Equity shall be held as Active Equity on the terms set out in Schedule [x];[360]

(c) the Black Shareholders shall be entitled to earn a return on their investment in the Project consistent with the returns forecast in the Financial Model,[361] *through their participation in:*

(i) the dividends and other distributions declared by the Private Party from time to time in respect of the Equity; and

(ii) the payments made to the Shareholders in respect of the Shareholder Loans.

*(d) The Private Party shall furnish the Institution annually within [x] Business Days after the end of each financial year of the Private Party a report certified by the Private Party's auditors ("**Annual BEE Report**") setting forth, in relation to each Shareholder:*

(i) the Equity ownership of that Shareholder and details of all changes whatsoever in such ownership in that financial year (including, without limitation, changes effected through any acquisition or disposal of issued shares, or through any subscription for new shares);

(ii) the Shareholder Loans of that Shareholder and details of all changes in the amount of such Shareholder Loans in that financial year (including, without limitation, changes effected through repayments);

(iii) the voting rights attaching to all classes of Equity owned by that Shareholder in that financial year; and

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359 If the PPP Agreement makes provision for the ramp-up of the minimum Black Equity allocation over the Project Term, then this Standard Clause will need to be amended. Where provision is made for a ramp-up, the minimum Black Equity allocations over the duration of the Project Term must be specified and must be coupled to specified time-linked or performance-linked milestones.

360 The nature and extent of this Active Equity participation must be specified in a Schedule to the PPP Agreement.

361 The Financial Model must reflect how early cash flows for the Black Shareholders will be structured and the projected timeline for such cash flows.

(iv) *details of all dividends and other distributions declared to and received by that Shareholder in respect of its Equity, as well as all payments made to that Shareholder in respect of any Shareholder Loans, in that financial year.*

57 PRIVATE PARTY MANAGEMENT AND EMPLOYMENT EQUITY

57.1 The PPP Agreement must incorporate the requirements of the Institution in relation to the number of appointments of Black People to senior management and executive positions and the enhancement of employment equity and skills development, plus any additional commitments made by the Private Party in respect of these BEE targets. At a minimum it must reflect the principles set out below.

57.2 The Private Party must commit to achieving and maintaining a minimum level of participation[362] by Black People in the Management Control of the Private Party. If there is a requirement for this participation to ramp-up over the Project Term, then the PPP Agreement must set forth the milestones for the achievement of these ramp-ups.[363]

57.3 A significant portion[364] of this participation in the Management Control of the Private Party must be by Black Women.

57.4 The Private Party[365] must commit to meeting the employment equity targets contained in its employment equity plan in force from time to time.[366] In terms of the Employment Equity Act, 1998, these plans may not be for periods in

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[362] The Institution must establish this participation on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This participation must be stipulated in the RFP.

[363] Institutions must determine whether such a ramp-up is appropriate for their PPPs, having regard to affordability and value for money considerations. If an Institution elects to follow this route it should ensure that this election is stipulated in the RFP and that the PPP Agreement specifies the milestones by when the agreed minimum increases in these appointments must be achieved so that compliance can be effectively monitored.

[364] The Institution must establish this portion on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This portion must be stipulated in the RFP.

[365] Since the Project Deliverables will usually be subcontracted to the Subcontractors, the Private Party may not have many employees. Employment equity targets must nevertheless be addressed here in addition to those at the Subcontractor level. In this regard, see Section 58 (*Subcontracting*).

[366] In terms of the Employment Equity Act, 1998, only "designated employers" are required to submit these plans. This term excludes, among others, an employer employing less than 50 employees, unless that employer's annual turnover equals or exceeds the minimum turnover applicable to the type of business it conducts as prescribed in this Act. It is likely that the annual turnover of Private Parties will exceed the applicable minimum threshold in this Act. Accordingly, even if a Private Party employs less than 50 people it is likely to qualify as a "designated employer" for the purposes of this Act. Institutions must obtain specific legal advice in this regard in the procurement phase of the Project. However, even if the Private Party is not a designated employer for the purposes of this Act, the Institution should ensure that the PPP Agreement imposes obligations on the Private Party similar to those in this Act as if the Private Party were a designated employer.

excess of five years and must be updated before they expire. The PPP Agreement should therefore anticipate and cater for the compulsory substitution of these plans pursuant to that Act.

57.5 The Private Party must commit to the minimum skills development targets set for the Private Party per annum. These targets must be set forth in a Project-specific skills development plan covering the entire Project Term. The Private Party must also commit to applying a minimum amount, expressed as a percentage of the Private Party's Project-specific annual payroll expenditure budget,[367] for such purpose.[368] Depending on the Institution's objectives for local socio-economic BEE targets, it may consider agreeing with the Private Party that if the Private Party is able to achieve its annual skills development targets without fully expending the minimum required amount, then the costs savings achieved must be applied by the Private Party in achieving agreed local socio-economic targets specified in the PPP Agreement or new skills development targets.

Standard Clause

Private Party Management and Employment Equity

(a) The Private Party shall ensure that:

(i) [by no later than [date]][369], no less than [number/percentage] of the Private Party's senior management and executive appointments specified in Schedule [x] shall be filled by Black People [and that the percentage proportion of Black People in such positions shall increase by no less than [number/percentage] every [period] thereafter until the end of the Project Term][370]; and

367 This minimum amount should not be confused with the skills development levy imposed on certain employers pursuant to the Skills Development Levies Act, 1999. This minimum must be applied to the skills development of staff employed in the PPP itself.

368 This Standardisation does not prescribe the minimum percentage allocation. The Institution must determine this allocation with reference to affordability and value for money considerations and seek specific guidance in this regard from the relevant Treasury.

369 Institutions should bear in mind that during the construction phase of a Project, the Private Party may not need a full staff complement. Accordingly, this obligation may only need to be met, for example, by or before the Scheduled Service Commencement Date. Institutions should consider on a project-by-project basis what timing considerations are appropriate, and amend this Standard Clause as appropriate.

370 As indicated above, a ramp-up in the number of appointments of Black People in senior management and executive positions is not prescribed. If no ramp-up is required, then this provision in the Standard Clause must be deleted.

(ii) no less than [number/percentage] of the minimum number of appointments in Clause (a)(i) are filled by Black Women.

(b) The Private Party shall comply with the Employment Equity Act, 1998 and implement its current employment equity plan, as substituted from time to time in accordance with that Act.[371] *The Private Party shall furnish the Institution with:*

(i) each successive employment equity plan submitted by the Private Party in accordance with that Act within [x] days following the date of submission of that plan; and

(ii) a copy of each report submitted by the Private Party to the Department of Labour (or its successor) pursuant to section 21 of that Act within [x] days following the date of submission of that report.

*(c) The Private Party shall implement its skills development plan [which is attached as Schedule [x] hereto] in accordance with Schedule [x] and shall apply no less than an amount (the "**Annual Skills Development Commitment**") equal to [x] percent of its annual payroll expenditure in any financial year towards the costs of implementing its skills development targets for that financial year.*[372]

(d) The Private Party shall include in its Annual BEE Report for each financial year:

(i) a complete statement of all targets set forth in the skills development plan for that financial year that have been achieved by the Private Party in that financial year, together with details of the costs incurred by the Private Party in that financial year in respect of such targets;

(ii) a complete statement of all targets (if any) set forth in the skills development plan for that financial year that have not been achieved by the Private Party in that financial year, together with the Private Party's reasons for not achieving these targets; and

(iii) details of the portion (if any) of its Annual Skills Development Commitment for that financial year not applied by the Private Party towards the implementation of any of its skills development targets for that financial year, together with the

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371 In terms of the Employment Equity Act, 1998, the duration of these employment equity plans may not exceed five years. Employers are obliged under this Act to update their employment equity plans before they expire.

372 If the Institution has agreed with the Private Party that savings in the minimum expenditure requirements for skills development may be applied in achieving local socio-economic BEE targets or new skills development targets, then this Standard Clause must be appropriately amended. The empowerment monitoring provisions in the PPP Agreement will also have to capture this principle.

Private Party's reasons for not applying the full Annual Skills Development Commitment in that financial year.

58 SUBCONTRACTING

58.1 The PPP Agreement must incorporate the BEE targets set by the Institution in relation to the subcontracting arrangements of a Project, plus any additional commitments made by the Private Party in respect of these BEE targets. At a minimum it must reflect the principles set out below.

58.2 The PPP Agreement must reflect the Private Party's undertakings in respect of these BEE targets. It is important for Institutions to bear in mind that because of the approach taken in this Standardisation to the allocation of Subcontractor risk, they should not attempt to get direct undertakings from the Subcontractors in regard to these BEE targets. Furthermore, while the Institution should monitor the implementation of these BEE targets at the Subcontractor level and ensure that the empowerment monitoring regime in the PPP Agreement provides for it to do so, it should avoid micro-managing these arrangements in view of this risk allocation.

58.3 The PPP Agreement must specify the minimum level of participation[373] (expressed as a percentage participation) by Black Enterprises and/or Black People either in the ownership of equity in any Subcontractor which will participate in the Capital Expenditure forecast to be incurred by the Private Party under the Subcontracts, or in that Capital Expenditure itself (directly or indirectly). This participation may involve, among other things, a direct equity participation[374] by Black People and/or Black Enterprises in the Construction Subcontractor, or the assignment of a percentage of the entire Capital Expenditure subcontract value to Black People and/or Black Enterprises and/or a combination of these.

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[373] The Institution must establish this percentage participation on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This proportion must be stipulated in the RFP.

[374] If so, then the Institution should consider (depending on the extent of the requirement for Active Equity in the Private Party, as well as affordability and value for money considerations) whether there should also be a minimum requirement for a portion of this direct equity participation at the Subcontractor level to be held as Active Equity. Such portion (which may vary for each Subcontractor) should be established on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act, and should be stipulated in the RFP.

58.4 The PPP Agreement must also specify the minimum level of participation[375] (expressed as a percentage participation) by Black Enterprises and/or Black People either in the ownership of equity in any Subcontractor which will participate in the Operating Expenditure forecast to be incurred by the Private Party under the Subcontracts, or in that Operating Expenditure itself (directly or indirectly). This participation may involve, among other things, a direct equity participation[376] by Black People and/or Black Enterprises in the Operations Subcontractor, or the assignment of a percentage of the entire Operating Expenditure subcontract value to Black People and/or Black Enterprises and/or a combination of these.

58.5 This Standardisation does not prescribe how the participation in Section 58.3 or Section 58.4 should be structured, nevertheless the extent of such participation must always be capable of being measured as a percentage participation in the total Capital Expenditure cash flows and Operating Expenditure cash flows to the Subcontractors.

58.6 The Private Party must also commit to procuring that a minimum level of participation[377] by Black People in the Management Control of each of the Subcontractors will be achieved and maintained. If there is a requirement for this participation to ramp-up over the Project Term, then the PPP Agreement must set forth the milestones for the achievement of these ramp-ups.[378]

58.7 A significant portion[379] of this participation in the Management Control of each Subcontractor must be by Black Women.

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375 The Institution must establish this percentage participation (which may vary for each Subcontractor) on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This participation must be stipulated in the RFP.

376 The comments at footnote 374 also apply here.

377 The Institution must establish this participation (which may vary for each Subcontractor) on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This participation must be stipulated in the RFP.

378 Institutions must determine whether such a ramp-up is appropriate for their PPPs having regard to affordability and value for money considerations. If an Institution elects to follow this route it should ensure that this election is notified to all the bidders in the RFP and that the PPP Agreement specifies the milestones by when the agreed minimum increases in these appointments must be achieved so that compliance can be effectively monitored.

379 The Institution must establish this portion (which may vary for each Subcontractor) on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. This portion must be stipulated in the RFP.

58.8 The Private Party must commit to procuring that the Subcontractors will achieve and maintain the employment equity targets contained in their respective employment equity plans in force from time to time.[380] The PPP Agreement must also include a commitment by the Private Party to procure that the Institution is furnished with the most recent employment equity plans of each Subcontractor, and with all annual employment equity reports which each Subcontractor is required to file in terms of the Employment Equity Act, as soon as these plans and reports are filed with the relevant authority under that Act, namely, the Department of Labour (or its successor).

58.9 The Private Party must commit to procuring that each Subcontractor will achieve and maintain the Project-specific skills development targets[381] set for it in the RFP (and any additional skills development targets which have been committed in the bid and negotiation phases) and will apply a minimum amount, expressed as a percentage of that Subcontractor's annual Project-specific payroll expenditure,[382] for such purpose.[383] Depending on the Institution's objectives for local socio-economic BEE targets, it may consider agreeing with the Private Party that if any Subcontractor is able to achieve its skills development targets for the Project without fully expending the minimum required amount, then the costs savings achieved must be applied by the Subcontractor in achieving the local socio-economic targets specified in the PPP Agreement or new skills development targets.

58.10 The Private Party must commit to procuring that each Subcontractor will spend a minimum portion (expressed as a percentage) of its total

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380 Institutions should ensure that their RFPs require the bidders to submit the most current employment equity plans of their proposed first-tier Subcontractors as part of their bid documents. These plans must be reviewed by the Institutions during the due diligence phase of the Project. The purpose of this review is to identify the employment equity targets of the proposed first-tier Subcontractors and establish the quality of the existing employment equity measures being undertaken by them.

381 The Institution must establish these targets (which may vary for each Subcontractor) on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. These targets must be stipulated in the RFP.

382 This minimum amount should not be confused with the skills development levy imposed on certain employers pursuant to the Skills Development Levies Act, 1999.

383 This Standardisation does not prescribe the minimum percentage allocation. The Institution must determine this allocation having regard to affordability and value for money considerations. Institutions must also seek guidance regarding the appropriate allocation from the relevant Treasury.

Project-specific procurement budget pursuant to procurement contracts with SMME suppliers and service providers.[384]

Standard Clause

Subcontracting

The Private Party shall ensure that:

(a) no less than [x] percent of the total Capital Expenditure forecast in the Financial Model to be incurred by the Private Party shall be expended under Subcontracts in which Black People and/or Black Enterprises will participate in the manner described in Schedule [x];

(b) no less than [x] percent of the total Operating Expenditure forecast in the Financial Model to be incurred by the Private Party shall be expended under Subcontracts in which Black People and/or Black Enterprises will participate in the manner described in Schedule [x];

(c) no less than:

(i) [number/percentage] of [each Subcontractor's][385] the senior management and executive appointments specified in Schedule [x] shall be filled by Black Persons [and that the percentage proportion of Black People in such appointments shall increase[386] by no less than [x] percent every [period] thereafter until the end of the Project Term]; and

(ii) [number/percentage] of the minimum number of appointments specified in Clause (c)(i) are filled by Black Women.

(d) each Subcontractor implements that Subcontractor's current employment equity plan, as substituted from time to time in accordance with the Employment Equity Act, 1998. The Private Party shall furnish the Institution with or cause the Institution to be furnished with:

(i) each successive employment equity plan submitted by that Subcontractor in terms of that Act within [x] days following the date of submission of that plan; and

(ii) a copy of each report submitted by that Subcontractor to the Department of Labour (or its successor) pursuant to

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384 The Institution must establish these procurement targets (which may vary for each Subcontractor) on a project-by-project basis during the feasibility study phase of the Project, taking into account relevant sector-specific charters issued in terms of the BBBEE Act. These targets must be stipulated in the RFP.

385 If the allocation is different for each Subcontractor, then appropriate amendments will need to be made to this Standard Clause.

386 The comments in footnote 370 are also applicable here.

section 21 of that Act within [x] days following the date of submission of that report;

(e) *each Subcontractor shall meet the annual skills development targets set forth in Schedule [x] hereto and shall apply no less than an amount equal to [x] percent of that Subcontractor's annual payroll expenditure in any financial year towards the costs of implementing its skills development targets for that financial year;*[387] *and*

(f) *each Subcontractor shall expend no less than [x]% of the total procurement budget of that Subcontractor in respect of the Project under procurement contracts with SMMEs.*

59 LOCAL SOCIO-ECONOMIC IMPACT

59.1 The prescribed approach for PPPs entails that the Private Party undertakes clear commitments in respect of direct socio-economic benefits for communities located in its area of operation. These benefits may include:

59.1.1 direct benefits to non-profit organisations, child-care centres, civic associations, primary health-care clinics and the like;

59.1.2 employment preferences for the disabled and the youth; and

59.1.3 procurement preferences for those SMMEs that are located in its area of operation.

59.2 The nature and scope of these commitments will depend on the needs of local communities and, therefore, will vary from project-to-project.[388] The PPP Agreement must incorporate the requirements of the Institution in relation to its local socio-economic BEE targets, plus any additional commitments by the Private Party in regard to these BEE targets, in precise, measurable and quantifiable terms.

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[387] If the Institution has agreed with the Private Party that savings in the minimum expenditure requirements for skills development must be applied in achieving local socio-economic BEE targets or other skills development targets, then this Standard Clause must be appropriately amended. The empowerment monitoring provisions in the PPP Agreement will also have to capture this principle.

[388] During the conduct of their feasibility studies, Institutions should assess these needs (taking into account relevant sector-specific charters issued in terms of the BBBEE Act) and specify them and the Institution's related BEE targets in their RFPs. However, the bidders should be encouraged to be innovative and therefore be allowed to propose additional or alternative local socio-economic targets (provided these are an improvement on those proposed by the Institution itself).

PART N: TERMINATION

60 CAUSES OF TERMINATION

60.1 Introduction

60.1.1 A Project may be terminated prior to the Expiry Date for any one of the following reasons:

60.1.1.1 Institution Default;

60.1.1.2 Private Party Default;

60.1.1.3 Force Majeure; or

60.1.1.4 Corrupt Acts (see Section 60.5 (*Termination for Corrupt Acts*)).

60.1.2 The reasons listed above should be the only reasons for termination and the Institution should not be entitled to terminate the PPP Agreement for convenience even if it is of the view that it is better equipped to render the Services itself.

60.1.3 The PPP Agreement must deal with the consequences of all types of termination. Usually, irrespective of the reason for termination, the Project Assets are dealt with in the same way on termination (see Section 62 (*Handback*)). The major difference between the different types of termination is the level of compensation (if any), payable to the Private Party in such event.

60.2 Termination for Institution Default

60.2.1 The PPP Agreement should clearly stipulate the events that would constitute an Institution Default and which would entitle the Private Party to terminate the PPP Agreement. As certain breaches by the Institution constitute Compensation Events that would entitle the Private Party to compensation[389] (see Part J:47 (*Relief Events, Compensation Events and*

[389] The Private Party will not have a right to terminate in these circumstances.

Force Majeure: Compensation Events)), the Institution Default should be limited to those breaches by the Institution which render the contractual relationship between the Parties untenable or completely frustrate the Private Party's ability to perform its obligations under the PPP Agreement. The Institution should, however, ensure that the Private Party always has a remedy for a breach by the Institution of its obligations under the PPP Agreement. The more serious breaches that render continuation of the Project impossible should constitute events of default.

Standard Definition

*"**Institution Default**" means any one of the following events:*

(a) an expropriation of a material part of the Project Assets and/or shares of the Private Party[390] *by the Institution or other Responsible Authority;*

(b) a failure by the Institution to make payment of any amount or amounts that are due and payable by the Institution under this PPP Agreement (which amounts are not in dispute) which, either singly or in aggregate exceeds the sum of R ( )[391] *(index linked) and such failure continues for [x]Business Days from receipt by the Institution of a notice of non-payment from the Private Party;*[392]

(c) a breach by the Institution of its obligations under this PPP Agreement which substantially frustrates[393] *or renders it impossible for the Private Party to perform its obligations under this PPP Agreement for a continuous period of [x] months; and*[394]

(d) a breach by the Institution of its obligations in terms of Clause[x](Assignment).[395]

390 This may be extended to cover the assets and shares of the Construction Subcontractor and/or the Operations Subcontractor if such an expropriation or sequestration would prevent the Private Party from performing its obligations under the PPP Agreement.

391 The amount to be inserted will depend on the particular project.

392 This provision assumes that interest on late payment is provided for in the PPP Agreement (see Part H: (*Payment and Financial Matters*)).

393 If it is possible to identify specific breaches by the Institution that would of necessity completely frustrate the Private Party's ability to comply with its obligations or render the Parties' contractual relationship untenable, this list could be expanded. One example in the context of a toll road project would be the failure by SANRAL to furnish the Minister of Transport with the required information for the setting of toll tariffs. Another example would be failure to enact a specific piece of requisite legislation. Care must be taken, however, to ensure that termination is a last resort and can only be chosen by the Private Party when the Institution's action or inaction has made it impossible for the Private Party to perform its obligations under the PPP Agreement.

394 The periods triggering Institution Default are subject to the further remedy periods set out in Part N: (*Termination*).

395 See Part S:83.1 (*Miscellaneous: Assignment*).

60.2.2 Beyond this, the circumstances in which the Private Party is permitted to terminate for Institution Default must be considered on a project-by-project basis. The Institution needs to examine the nature of its obligations during the PPP Agreement and should only extend the list of Institution Default events to include breaches of other obligations that will render the contractual relationship untenable or completely frustrate the Private Party's ability to deliver the Services.

60.2.3 Termination by the Private Party should be a last resort and it is important to ensure that there are no "hair-triggers" which could put the Institution at risk. There can be no question of reciprocity with Private Party Default since the obligations of the Institution are principally payment obligations and approval rights rather than detailed performance obligations or obligations which affect third party rights (such as those of the Private Party's funders). The Private Party should bear in mind that a failure by the Institution to comply with the provisions of the PPP Agreement before Service Commencement (for example, issuing approvals) and sometimes after that date can, in most cases, be adequately dealt with by way of a Compensation Event (see Part J:47 (*Relief Events, Compensation Events and Force Majeure: Compensation Events*)). In addition, any failure by the Institution to make the Unitary Payments when due should give rise to interest on late payment (see Part H: (*Payment and Financial Matters*)) and so a reasonable grace period for non-payment should be built into the PPP Agreement. Neither of these should trigger termination.

Standard Clause

<u>Termination for Institution Default</u>

(a) On the occurrence of an Institution Default, or within [x] days after the Private Party becomes aware of same, the Private Party may serve notice on the Institution of the occurrence (and specifying details) of such Institution Default. If the relevant Institution Default has not been remedied or rectified within [x][396] Business Days of such notice, the Private Party may serve a further

[396] This will vary from project to project and must be sufficient to enable the Institution to remedy the default.

notice on the Institution terminating this PPP Agreement (save for Clauses [x, y and z])[397] with immediate effect.

(b) The Private Party shall not exercise or purport to exercise any rights to terminate this PPP Agreement (or accept any repudiation of this PPP Agreement) except as expressly provided for herein.

60.3 **Termination for Private Party Default**

60.3.1 The PPP Agreement must deal comprehensively with the possibility of early termination owing to Private Party Default. It must achieve a fair balance between the Institution's desire to be able to terminate for inadequate Services provision, even if caused by relatively minor defaults (a right which the Institutions have in conventional service contracts), and the Private Party's and its funders' interests in restricting termination to the severest of defaults when all other reasonable alternative options have been exhausted, including reasonable rectification opportunities and step-in rights pursuant to a Direct Agreement (see Part O: (*Step-in*)). It should be the Institution's last resort to exercise rights of termination.

60.3.2 The PPP Agreement should specify the events of Private Party Default that may lead to termination. As far as practicable, these should be objective, clear and provide for reasonable tolerances,[398] bearing in mind the undesirable consequences of a termination.

Standard Definition

*"**Private Party Default**"[399] means any of the following events or circumstances:*

(a) any arrangement, composition or compromise with or for the benefit of creditors (including any voluntary arrangement as defined in the Insolvency Act, 1936 or the Companies Act, 1973) being entered into by or in relation to the Private Party;

(b) a liquidator, judicial manager or the like taking possession of or being appointed over, or any judicial management, winding-up, execution or other process being levied or enforced (and not

[397] This must refer to those Clauses that are to survive termination of the PPP Agreement, such as the Clause dealing with the effects of termination.

[398] For example with Penalty Deductions accumulating, and only triggering termination when a specific threshold is reached.

[399] These may be expanded depending on the specifics of the Project.

being discharged within [x] Business Days) upon, the whole or any material part of the assets of the Private Party (in any of these cases, where applicable, whether provisional or final, and whether voluntary or compulsory);

(c) *the Private Party ceases to carry on business;*

(d) *a resolution being passed or an order being made for the administration or the judicial management, winding-up, liquidation or dissolution of the Private Party (in any of these cases, where applicable, whether provisional or final and whether voluntary or compulsory);*

(e) *the Private Party fails to complete the Works on or before the Long Stop Date;*[400]

(f) *the Private Party commits a breach of any of its material obligations under this PPP Agreement not covered by sub-Clauses (a), (b), (c), (d), (e), (g), (h), (i), (j), (k), (l), (m), (n), (o) or (p);*

(g) *the Private Party abandons the Works (other than as a consequence of a breach by the Institution of its obligations under this PPP Agreement);*

(h) *the Private Party ceases to provide all or a substantial part of the Services in accordance with this PPP Agreement (other than as a consequence of a breach by the Institution of its obligations under this PPP Agreement);*

(i) *the Private Party fails to comply with any of its obligations in Clauses [x] to [y];*[401]

(j) *the Private Party fails to comply with any provision of Clause [x](Assignment), Clause [y][the Clause dealing with the replacement of the Subcontractors] and Clause [z] (Changes in Control and Black Equity)*[402]*;*

(k) *the accumulation of [x] or more Penalty Deductions in any year/quarter;* [403]

(l) *the Private Party fails to pay any sum or sums due to the Institution under this PPP Agreement (which sums are not in dispute) which, either singly or in aggregate, exceed(s) R[x] (indexed to [CPIX]) and such failure continues for [x]Business*

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[400] Regard being had to the severe consequences of failing to complete the Works by the Long Stop Date, it is essential that this date be realistic, taking into account the nature of the Project while still incentivising the Private Party to complete the Works timeously. See also footnote 289.

[401] This Standard Clause (i) refers to all the Clauses in the PPP Agreement dealing with the Private Party's BEE obligations. See Part M: (*Black Economic Empowerment*).

[402] See Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*).

[403] This assumes that the PPP Agreement has provisions for the allocation of Penalty Deductions in respect of defaults on the part of the Private Party that in and of themselves are not sufficient to constitute Private Party Default. This is a very useful way of dealing with persistent breaches or accumulated but unrelated breaches. (See Part F: (*Services*) and Part H: (*Payment and Financial Matters*)).

Days from receipt by the Private Party of a notice of non payment from the Institution;

(m) *the Private Party fails to obtain and maintain any Project Insurances as required in terms of Clause [x] (Insurance*);

(n) *termination of the Financing Agreements as a result of any default or acceleration of any amounts under the Financing Agreements*;

(o) *any breach of any provision of this PPP Agreement has occurred more than once and:*

(i) *the Institution has given an initial warning notice to the Private Party describing that breach in reasonable detail and stating that if that breach persists or recurs then the Institution may take further steps to terminate this PPP Agreement; and*

(ii) *the Institution has issued a second and final warning notice following the persistence or recurrence of that breach in the period of [x] days after the initial warning notice, stating that if that breach persists or recurs within the period of [x] days after the final warning notice then the Institution may terminate this PPP Agreement on [x] days' notice to the Private Party;*[404] *and*

(p) *any breach of the refinancing provisions.*

60.3.3 Termination should be subject to remedy procedures and the rights of the Lenders under their Direct Agreement with the Institution. Prior to exercising its right to terminate for Private Party Defaults that are capable of being remedied,[405] the Institution must serve a Pre-termination Notice[406] on the Lenders which will trigger certain rights under the Direct Agreement that the Lenders will be entitled to exercise prior to the Institution exercising its right to terminate the PPP Agreement (see Part O: (*Step-in*)). The PPP Agreement should provide a mechanism which allows the Private Party to remedy breaches that are capable of being remedied in order to avoid termination. However, not all breaches may be remediable, or give rise to remedy opportunities: for example failure to complete the Works by the Long Stop Date or insolvency.

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[404] Appropriate time periods will have to be inserted. These will depend on the nature of the Project. Also, this persistent breach provision is meant to cover breaches that are not covered by the Payment Mechanism at all or alternatively where the payment mechanism does not have a ratchet mechanism to cater for persistent breach. See Part F: (*Services*).

[405] See Standard Clause b(ii) below for a list of these events.

[406] See Part O: 74 (*Step-in: Standard Direct Agreement*) for the definition of Pre-termination Notice.

Standard Clause

Termination for Private Party Default

(a) *Notification*

The Private Party shall notify the Institution of the occurrence, and details, of any Private Party Default and of any event or circumstance which is likely, with the passage of time or otherwise, to constitute or give rise to a Private Party Default, in either case promptly on the Private Party becoming aware of its occurrence.

(b) *Institution's Options*

On the occurrence of a Private Party Default, or within a reasonable time after the Institution becomes aware of the same, the Institution may:

(i) in the case of the Private Party Default referred to in Clauses (a), (b), (c), (d), (e) and (k),[407] *terminate this PPP Agreement in its entirety by notice in writing having immediate effect;*

(ii) and while the same is subsisting, in the case of any other Private Party Default referred in sub-Clauses (f), (g), (h), (i), (j), (l), (m), (n), (o) and (p)[408] *serve notice of default on the Private Party requiring the Private Party at the Private Party's option either:*

(aa) to remedy the Private Party Default referred to in such notice of default (if the same is continuing) within [x] Business Days of such notice of default; or

(bb) to put forward within 20 (twenty) [x] Business Days of such notice of default a reasonable programme for remedying the Private Party Default. The programme shall specify in reasonable detail the manner in, and the latest date by, which such Private Party Default is proposed to be remedied. The Private Party shall only have the option of putting forward a programme in accordance with this Clause if it first notifies the Institution within [x] Business Days of such notice of default that it proposes to do so.

[407] These are meant to cover those Private Party Defaults that are not capable of being remedied or which will give rise to summary termination rights.

[408] These are Private Party Defaults that are capable of being remedied.

(c) *Remedy Provisions*

(i) *Where the Private Party puts forward a programme in accordance with Clause (b), the Institution shall have [x] Business Days from receipt of the same within which to notify the Private Party that it does not accept the programme, failing which the Institution shall be deemed to have accepted the programme. The Institution shall act reasonably in rejecting the programme. Where the Institution notifies the Private Party that it does not accept the programme, the Parties shall endeavour within the following [x] Business Days to agree any necessary amendments to the programme put forward. In the absence of agreement within [x] Business Days, the question of whether the programme (as the same may have been amended by agreement) will remedy the Private Party Default in a reasonable manner and within a reasonable time period (and, if not, what would be a reasonable programme) may be referred by either Party for resolution in accordance with Clause [x] (Fast-track Dispute Resolution).*

(ii) *If:*

(aa) *the Private Party Default notified in a notice of default is not remedied before the expiry of the period referred to in the notice; or*

(bb) *where the Private Party puts forward a programme which has been accepted by the Institution or has been determined to be reasonable, the Private Party fails to achieve any element of the programme or to complete the programme by the specified end date for the programme (as the case may be); or*

(cc) *any programme put forward by the Private Party is rejected by the Institution as not being reasonable, and the dispute resolution procedure does not find against that rejection,*

then the Institution may, subject to the Lenders' rights under the Direct Agreement,[409] *terminate this PPP Agreement in its entirety by written notice to the Private Party with immediate effect; provided that for the purposes of Clause (d)(ii) if the Private Party's execution of the programme is adversely affected by the occurrence of an event of Force Majeure or a Relief Event then, subject to the Private Party complying with the mitigation and other requirements in this PPP Agreement concerning Force Majeure or Relief Events (as the case may be), the time for execution of the*

[409] See Part O: 73 (*Step-in: By the Lenders*).

programme or any relevant element of it shall be deemed to be extended by a period equal to the delay caused by the Force Majeure event or Relief Event (as the case may be) which is agreed by the Parties or determined in accordance with Clause [x] (Fast-track Dispute Resolution).

(d) *Institution's Costs*

(i) *The Private Party shall reimburse the Institution with all costs incurred by the Institution in exercising any of its rights in terms of this Clause. The Institution should take reasonable steps to mitigate such costs.*

(ii) *The Institution shall not exercise, or purport to exercise, any right to terminate this PPP Agreement except as expressly set out in this PPP Agreement. The rights of the Institution (to terminate or otherwise) under this Clause are in addition (and without prejudice) to any other right which the Institution may have in law to claim the amount of any direct loss or damages suffered by the Institution on account of the acts or omissions of the Private Party (or to take any action other than termination of this PPP Agreement).*

60.4 **Termination for Force Majeure**

To the extent that an event of Force Majeure has occurred and the Parties have been unable to agree upon a mutually acceptable solution for dealing with the consequences of the event of Force Majeure, either Party should be entitled to terminate the PPP Agreement. The event of Force Majeure will by this time have subsisted for a substantial period[410] during which all or at least a material portion of the Project Deliverables would not have been performed. The Private Party should be compensated on termination for Force Majeure (see Section 66 (*Compensation on Termination for Force Majeure*).

Standard Clause

Termination for Force Majeure

If, in the circumstances referred to in Clause [x] (Force Majeure) the Parties have failed to reach agreement on any modification to this PPP Agreement pursuant to that Clause within [x] [411] *months of the date on which the Party affected serves notice on the other Party in accordance with that Clause, either Party may at any time afterwards terminate this PPP Agreement by*

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

[411] The market practice has been for this period to be 180 days in any 365 day period.

written notice to the other Party having immediate effect, provided always that the effects of the relevant events of Force Majeure continue to prevent either Party from performing any material obligation under this PPP Agreement.

60.5 **Termination for Corrupt Acts**

60.5.1 The "Corrupt Acts" provisions in this Standardisation are aimed at all types of bribery, corruption and fraud perpetrated against the Institution in connection with the procurement and the ongoing performance of the PPP Agreement. It includes gifts, payments and all other Corrupt Acts. In this Section 60.5 they are all referred to as "Corrupt Acts".

60.5.2 The PPP Agreement must deal comprehensively with the consequences of Corrupt Acts. It must make provision for the Institution to terminate the PPP Agreement for Corrupt Acts in certain circumstances.

60.5.3 As the Institution's ultimate remedy for any Corrupt Act is severe, the prescribed approach allows the Private Party the opportunity to avoid termination in the circumstances described below:

60.5.3.1 if the Corrupt Act is committed by the Private Party, a Shareholder, any director[412] of the Private Party or any director of a Shareholder, any employee of the Private Party acting under the authority of or with the knowledge of a director of the Private Party, or any employee of a Shareholder acting under the authority of or with the knowledge of a director of the Shareholder, then in any such case the Institution may terminate the PPP Agreement on notice of a minimum period as specified in the PPP Agreement and on payment by it of the full amount of the Debt (save as provided in Section 60.5.3.4 and Section 67 (*Compensation on Termination for Corrupt Acts*)). In addition, the Institution may recover from the Private Party the greater of any losses that it suffers as a result of the Corrupt Act and an amount equal to the value of the gift in question. If the Corrupt Act is the result of the action of any such employee acting on his or her own, then the Private Party should

[412] The term "director" as used in this Section 60.5 applies to an executive or non-executive director.

cause that employee's role in the Project to be terminated and, if a replacement is needed, cause that employee to be replaced within a specified period, which should be reasonable. If this is not done, then the PPP Agreement can be terminated on the same basis as would have applied if the employee had not been acting on his or her own;

60.5.3.2 if the breach is committed by a Subcontractor, a director of a Subcontractor or an employee of a Subcontractor acting under the authority of or with the knowledge of a director of the Subcontractor, then the Institution may terminate the PPP Agreement as if this were a Corrupt Act of the Private Party, but on notice of a minimum period as specified in the PPP Agreement, unless the Private Party replaces the relevant Subcontractor within the notice period. If the Corrupt Act is that of an employee of a Subcontractor acting on his or her own, then the Private Party must cause the Subcontractor to terminate that person's involvement in the Project and, if needed, procure a replacement within a specified period. If neither is done, then the PPP Agreement can be terminated on the same basis as if it were a Corrupt Act by the Private Party;

60.5.3.3 if a second-tier subcontractor or a supplier, a director of such subcontractor or supplier or an employee of such person acting under the authority or with the knowledge of a director of that subcontractor or supplier, as the case may be, commits the Corrupt Act, then the Institution may terminate the PPP Agreement on notice of a minimum period as specified in the PPP Agreement as if this were a Corrupt Act of the Private Party, unless within a specified period after it has given notice of the Corrupt Act to the Private Party, the Private Party causes such subcontractor's or supplier's involvement in the Project to be terminated and, if needed, a replacement subcontractor or supplier to be appointed; and

60.5.3.4 where the Corrupt Act is committed by a Lender or involves a director of a Lender or an employee of a Lender not acting of his or her own accord but under the authority or with the knowledge of a director of the Lender (the "**Corrupt Lender**"), the termination of the PPP Agreement will not take effect if within the termination notice period the Private Party causes the Corrupt Lender's involvement in the co-financing of the Debt to be terminated and its outstanding financial commitment and participation in the Debt to be taken up by another Qualifying Financial Institution(s).[413] If an employee of a Lender was acting of his or her own accord, then the termination of the PPP Agreement will not take effect if the employee's involvement in the Project is terminated and, where necessary, he or she is replaced. Failing the termination of the involvement of the Corrupt Lender as aforesaid or, where an employee of a Lender was acting of his or her own accord then the termination of the involvement of such employee (and his or her replacement by another employee, if necessary), the PPP Agreement will terminate.

Standard Definition

*"**Corrupt Act**" means:*

(a) offering, giving or agreeing to give to the Institution or any other organ of state or to any person employed by or on behalf of the Institution or any other organ of state any gift or consideration of any kind as an inducement or reward:

(i) for doing or not doing (or for having done or not having done) any act in relation to the obtaining or performance of this PPP Agreement or any other contract with the Institution or any other organ of state; or

(ii) for showing or not showing favour or disfavour to any person in relation to this PPP Agreement or any other contract with the Institution or any other organ of state;

(b) entering into this PPP Agreement or any other contract with the Institution or any other organ of state in connection with which commission has been paid or has been agreed to be paid by the Private

413 See Part Q:79 (*Refinancing: Exemptions*) for the definition of "Qualifying Financial Institution".

Party or on its behalf, or to its knowledge, unless before the relevant contract is entered into particulars of any such commission and of the terms and conditions of any such contract for the payment of such commission have been disclosed in writing to the Institution;

(c) committing any offence:

(i) under any law from time to time dealing with bribery, corruption or extortion;

(ii) under any law creating offences in respect of fraudulent acts; or

(iii) at common law, in respect of fraudulent acts in relation to this PPP Agreement or any other contract with the Institution or any other public body; or

(d) defrauding or attempting to defraud or conspiring to defraud the Institution or any other public body.

Standard Clause

Termination for Corrupt Acts

(a) The Private Party warrants that in entering into this PPP Agreement it has not committed any Corrupt Act.

(b) If the Private Party, any Shareholder, any Subcontractor or any Affiliate of any of them (or anyone employed by or acting on behalf of any of them) commits or is reasonably suspected by the Institution of having committed any Corrupt Act, then the Institution shall be entitled to act in accordance with Clauses (b)(i) to (viii) below:

(i) if the Corrupt Act is committed by the Private Party, any Shareholder, any director of the Private Party, any director of any Shareholder, or any employee of the Private Party or of any Shareholder acting under the authority of or with the knowledge of a director of the Private Party or such Shareholder, as the case may be, then in any such case, the Institution may terminate this PPP Agreement with immediate effect by giving written notice to the Private Party;

(ii) if the Corrupt Act is committed by an employee of the Private Party or of any Shareholder acting of his or her own accord, then in any such case, the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of the Private Party's receipt of such notice that employee's involvement in the Project is terminated and (if necessary) the performance of any part of the Project Deliverables previously performed by him or her is performed by another person;

(iii) if the Corrupt Act is committed by a Subcontractor, director of a Subcontractor or an employee of a Subcontractor acting under the authority or with the knowledge of a director of that Subcontractor, then in any such case, the Institution may give written notice to the Private Party of termination and this

PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party terminates the relevant Subcontract and procures the performance of the relevant part of the Project Deliverables by another person, where relevant, in accordance with Clause [x] (Assignment);

(iv) *if the Corrupt Act is committed by an employee of a Subcontractor acting of his or her own accord, then the Institution may give notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party procures the termination of that employee's involvement in the Project and (if necessary) procures the performance of that part of the Project Deliverables previously performed by that employee to be performed by another person;*

(v) *if the Corrupt Act is committed by a Lender, a director of a Lender or any employee of a Lender acting under the authority or with the knowledge of a director of that Lender, then in any such case the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of its receipt of such notice the Private Party procures the termination of such Lender's involvement in the Project (in any capacity whatsoever including, without limitation, as Lender under the Financing Agreements) and provides the Institution with satisfactory proof that such Lender's entire participations in the Debt and in any undrawn financial commitments under the Financing Agreements have been assumed by any Qualifying Financial Institution(s) (including any one or more of the remaining Lenders);*

(vi) *if the Corrupt Act is committed by any employee of a Lender acting of his or her own accord, then the Institution may give written notice to the Private Party of termination and this PPP Agreement will terminate, unless within [x] Business Days of the Private Party's receipt of such notice, that employee's involvement in the Project is terminated;*

(vii) *if the Corrupt Act is committed by any other person not specified in Clauses (b)(i) to (b)(vi) above but involved in the Project as a subcontractor or supplier to any Subcontractor or to the Private Party, then the Institution may give notice to the Private Party of termination and this PPP Agreement will terminate unless within [x] Business Days the Private Party procures the termination of such person's involvement in the Project and (if necessary) procures the performance of the relevant part of the Project Deliverables by another person; and*

(viii) *any notice of termination under this Clause shall specify:*

(aa) *the nature of the Corrupt Act;*

(bb) *the identity of the party or parties who the Institution believes has committed the Corrupt Act; and*

(cc) *the date on which this PPP Agreement will terminate in accordance with the applicable provisions of this Clause.*

(c) *Without prejudice to its other rights or remedies under this Clause, the Institution shall be entitled to recover from the Private Party, the greater of:*

(i) *the amount or value of the gift, consideration or commission which is the subject of the Corrupt Act; and*

(ii) *any direct losses sustained by the Institution in consequence of any breach of this Clause by the Private Party.*

(d) *Nothing contained in this Clause shall prevent the Private Party from paying any proper commission or bonus to its employees within the agreed terms of their employment.*

(e) *The Private Party shall notify the Institution of the occurrence (and details) of any Corrupt Act promptly on the Private Party becoming aware of its occurrence.*

(f) *Where the Private Party is required to replace any Subcontractor pursuant to this Clause, the provisions of Clause [x][414] shall apply and be construed accordingly.*

61 EFFECTS OF TERMINATION

When either Party has exercised its right to terminate the PPP Agreement, the PPP Agreement will be terminated in accordance with its provisions and the Parties will generally no longer have any rights or obligations under this PPP Agreement. The PPP Agreement may, however, provide for certain provisions to survive its termination (such as certain indemnities) and the Parties will still have rights and obligations in respect thereof post termination. Also all rights and obligations of the Parties that have accrued prior to the termination may be enforced post termination. There are also certain rights and obligations that arise only as a result of termination of the PPP Agreement and these must be clearly provided for and must also be expressed to survive termination of the PPP Agreement. These should include the Private Party's obligation to clear the Project Site, the procedure for transfer of the Project Assets to the Institution[415] and the Private Party's obligations to assist in the transitional arrangements in relation to a new Private Party if the Institution decides to appoint one. It is important that these obligations on the part of the Private Party

[414] This should refer to the clauses of the PPP Agreement dealing with the replacement of the Subcontractors. See Part S: 83.2 (*Miscellaneous: Subcontracting*).

[415] See Section 62 (*Termination: Handback*).

are clearly stipulated in the PPP Agreement so as to ensure that the exit of the Private Party does not result in any delay or interruption in the provision of the Services. In certain projects, such as IT projects, it may be necessary to develop a detailed schedule in this regard.

Standard Clause

Effects of Termination

(a) *Termination*

Notwithstanding any provision of this PPP Agreement, on service of a notice of termination, this PPP Agreement shall only terminate in accordance with the provisions of this Clause.

(b) *Continued Effect – No Waiver*

Notwithstanding any breach of this PPP Agreement by either Party, and without prejudice to any other rights which the other Party may have in relation to it, the other Party may elect to continue to treat this PPP Agreement as being in full force and effect and to enforce its rights under this PPP Agreement. The failure of either Party to exercise any right under this PPP Agreement, including any right to terminate this PPP Agreement and any right to claim damages, shall not be deemed a waiver of such right for any continuing or subsequent breach.

(c) *Continued Performance*

Subject to any exercise by the Institution of its rights to perform, or to procure a third party to perform, the obligations of the Private Party, the Parties shall continue to perform their obligations under this PPP Agreement, notwithstanding the giving of any notice of default or notice of termination, until the termination of the PPP Agreement becomes effective in accordance with the provisions of this Clause.

(d) *Transfers to Institution of Assets, Contracts, etc. on Termination Only*[416]

On termination of this PPP Agreement in accordance with its terms for any reason:

(i) *if that occurs prior to the Service Commencement Date, in so far as any transfer shall be necessary fully and effectively to transfer the Project Site*[417] *to the Institution, the Private Party shall transfer to, and there shall vest in, the Institution such part of the Works and/or the Facilities as shall have been constructed and such items of the plant and*

[416] This may need to be amended to include project-specific provisions (for example, relating to equipment, IT, planning, land and Institution assets or information, and so forth). The Institution should consider what protection is required to ensure compliance with the handback provisions (see Section 62 (*Termination: Handback*)) on a project-specific basis (taking into account the nature, importance and value of the Project Assets to which the handback provisions will apply).

[417] This assumes that the Private Party has title in respect of the Project Site. In such event, the Project Site should not be encumbered as it will be required by the Institution to ensure continuation of the Services. To the extent that the Institution has made the Project Site available, as has been the market practice more often than not, this provision is not necessary.

equipment[418] *as shall have been procured by the Private Party, and if the Institution so elects:*

(aa) all plant and all materials on the Project Site or required for the purposes of completing the Works shall remain available to the Institution for the purposes of completing the Works; and

(bb) the construction plant shall remain available to the Institution for the purposes of completing the Works, subject to payment of the Private Party's reasonable costs;

(ii) if the Institution so elects, the Private Party shall procure that any of the Subcontracts specified by the Institution are assigned to the Institution or any third party nominated by it; provided that where termination occurs under Clause [x][the Clause dealing with Institution Default], the consent of the relevant Subcontractor(s) shall be required. Where the Institution does not so elect, or any Subcontractor whose consent is required refuses that consent, the Private Party shall procure that all relevant Subcontracts automatically terminate when this PPP Agreement terminates.[419]

(e) <u>Transfers to Institution on Termination or Expiry</u>

On termination of this PPP Agreement for any reason in accordance with its terms or within [x] days[420] *prior to the Expiry Date, the Private Party shall:*

(i) hand over to, and there shall vest in, the Institution, free from all encumbrances, the Project Assets,[421] *which in the case of expiry or termination of this PPP Agreement at the end of the Project Term shall be in the state required in accordance with Clause [x] (Handback); or*

(ii) procure that any Subcontractor shall (as the case may be), transfer to the Institution, free from any security interest full and unencumbered title in and to all or any part of the Project Assets required by the Institution in connection with the Project Deliverables;

(iii) procure that any Licensed Intellectual Property shall be provided to the Institution and the Institution shall, to the extent possible, be granted a perpetual non-exclusive, royalty-free licence to use such Licenced Intellectual Property;

(iv) deliver to the Institution (as far as not already delivered to the Institution) one complete set of:

(aa) "as built drawings" showing all alterations made to the Facilities since the commencement of operation of the Facilities;

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[418] Institution to add other project-specific items.

[419] The Institution's election will, however, not be triggered by the service of any "Pre-termination Notice" as defined in the Direct Agreement.

[420] The exact time will vary from project to project.

[421] This must refer only to those Project Assets that the Institution, at the RFP stage, informed the Private Party that it will require at the end of the Project Term and which were not to be encumbered by the Private Party. See Part G:36 (*Project Assets: Security Over Project Assets*).

(bb) *maintenance, operation and training manuals for the Facilities to the extent that they exist or the Private Party has an obligation in terms of this PPP Agreement to acquire or prepare them; and*

(cc) *the historical operating data and plans of the Facilities, its furniture, fittings and equipment in a format acceptable to the Institution;*

(v) *use all reasonable endeavours to procure that the benefit of all manufacturer's warranties in respect of mechanical and electrical plant and equipment used or made available by the Private Party under this PPP Agreement and included in the Project Assets are assigned, or otherwise transferred, to the Institution;*

(vi) *deliver to the Institution [the information referred to in the Clauses dealing with employment and pension matters and the records referred to in the Clause dealing with records and reports] except where such documents are required by law to be retained by the Private Party or any Subcontractor concerned (in which case complete copies shall be delivered to the Institution);*[422]

(vii) *ensure that provision is made in all relevant contracts of any description whatsoever to which the Private Party or any Subcontractor is a party to ensure that the Institution will be in a position to exercise its rights, and the Private Party will be in a position to comply with its obligations, under this Clause (e);*

(viii) *remove from the Project Site all property not required by the Institution pursuant to Clause (d) (Transfer to Institution of Assets, Contracts, etc.) and if it has not done so within [x]*[423] *Business Days after any notice from the Institution requiring it to do so the Institution may (without being responsible for any loss, damage, costs or expenses) remove and sell any such property and shall hold any proceeds less all costs incurred for the credit of the Private Party;*

(ix) *deliver to the Institution:*

(aa) *any keys, remote access apparatus and computer access cards to the Facilities; and*

(bb) *without prejudice to Clause [x] (Intellectual Property), any copyright licences for any computer programmes (or licences to use the same) necessary for the operation of the Facilities (but excluding computer programmes [which have been developed or acquired by the Private Party for its own use and not solely for the purposes of provision of any of the Services at the Facilities or the assignment or transfer of which is otherwise restricted]);*[424] *and*

[422] This is only relevant if the PPP Agreement provides for the Institution to take over the employees.

[423] This may vary depending on the specific project.

[424] This depends on the approach taken in relation to Intellectual Property. See Part R:82 (*Intellectual Property*).

(x) *vacate the Project Site and (without prejudice to Clause [x] (Handback)) shall leave the Project Site and the Facilities in a safe, clean and orderly condition.*

(f) *Transitional Arrangements*

For a period of [x] months[425] *both before and after the Expiry Date or in the case of any earlier termination for the period from the service of notice of termination to [x] months after the termination date, the Private Party shall have the following obligations:*

(i) *the Private Party shall co-operate fully with the Institution and any successor providing services to the Institution in the nature of any of the Services or any part of the Services in order to achieve a smooth transfer of the manner in which the Institution obtains services in the nature of the Services and to avoid or mitigate in so far as reasonably practicable any inconvenience or any risk to the health and safety of the employees of the Institution and members of the public;*[426]

(ii) *If the Institution wishes to conduct a tender process with a view to entering into a contract for the provision of services (which may or may not be the same as, or similar to, the Services or any of them) following the expiry or earlier termination of this PPP Agreement, the Private Party shall co-operate with the Institution fully in such tender process including (without limitation) by:*

(aa) *providing any information which the Institution may reasonably require to conduct such tender excluding any information which is commercially sensitive to the Private Party (and, for the purposes of this sub-Clause, commercially sensitive shall mean information which would if disclosed to a competitor of the Private Party or Subcontractor give that competitor a competitive advantage over the Private Party or Subcontractor and thereby prejudice the business of the Private Party or Subcontractor but shall exclude any [information referred to in the Clause dealing with employment matters])*[427]*; and*

(bb) *assisting the Institution by providing all (or any) participants in such tender process with access on reasonable notice and at reasonable times to the Project Site and the Project Assets subject to the Private Party's safety rules and regulations.*

(g) *Continuing Obligations*

Save as otherwise expressly provided in this PPP Agreement:

(i) *termination of this PPP Agreement shall be without prejudice to any accrued rights and obligations under this PPP Agreement as at the date of termination; and*

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[425] This will depend on the specific project.

[426] This assistance by the Private Party after the Expiry Date will no doubt have cost implications. The Institution may want to consider placing a limit, financially and otherwise, on this assistance as it will affect value for money.

[427] This depends on what has been agreed in relation to the take over of employees by the Institution.

(ii) *termination of this PPP Agreement shall not affect the continuing rights and obligations of the Private Party and the Institution under Clauses [ ] (Private Party Warranties),*[428]*[ ] (Institution Warranties), [ ] (Private Party Indemnities),*[429] *[ ] (Limitations on Liability), [ ] (Project Site Agreement), [ ] (Project Site Conditions), [ ] (Employment Matters), [ ] (Payment), [ ] (Insurance), [ ] (Force Majeure), [ ] (Effects of Termination), [ ] (Compensation on Termination), [ ] (Intellectual Property), [ ] (Confidentiality), [ ] (Reporting Requirements), [ ] (Access to Information), [ ] (Dispute Resolution), [ ] (Fast-track Dispute Resolution), [ ] (Notices and Legal Service), [ ] (Governing Law and Jurisdiction) or under any other provision of this PPP Agreement which is expressed to survive termination or which is required to give effect to such termination or the consequences of such termination.*

62 HANDBACK

62.1 The expected condition of the Project Assets on expiry of the PPP Agreement must be agreed with the Private Party and provided for in the PPP Agreement. In so far as the Institution requires the use of the Project Assets in order to continue the performance of the Services either itself or by engaging another Private Party after the Expiry Date, provision should be made for transfer of possession of, and unencumbered title over, the Project Assets to the Institution on the Expiry Date. At the Signature Date, the Parties must agree which Project Assets will be required by the Institution at the end of the Project Term. It is only these agreed Project Assets to which this Section 62 applies.[430]

62.2 If the Project Assets are to be transferred to the Institution[431] on the Expiry Date they must be in a condition where they have some remaining useful life in order to enable the Institution to provide the Services. The intention is not for the Private Party to ensure that the Institution may use the Project Assets indefinitely, but merely to ensure that the Institution is not in the position, at expiry of the Project Term, where all the Project Assets required for the

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428 The Clauses referred to here must extend to all warranties given by the Private Party not limited to the warranties contained in the Standard Clause in Part C:8 (*General Obligations: Warranties*) but also including other warranties given by the Private Party including the warranty concerning Corrupt Acts.

429 If there are any Institution Indemnities, then the relevant Clause should also be referred to here.

430 Institutions should inform bidders, at the RFP stage, of those assets that it will require at the end of the Project Term.

431 In so far as the Institution does not already have possession of, or title to, them.

Services have to be replaced simultaneously. The assets therefore must have some residual value at the Expiry Date.

62.3 The residual value means the market value of the Project Assets or the duration for which those assets can still be used after expiry of the PPP Agreement ("**Residual Value**"). The Residual Value required will vary from project to project.[432] For example, a PPP in the IT sector may require a much shorter remaining useful life in respect of the Project Assets than one in an accommodation project. It is also often not feasible or practical to have one standard that applies to all the Project Assets as a result of their varying nature and purpose. Project Assets could be grouped using criteria that would enable the Project Assets in a category to be dealt with in the same or similar fashion. To cater for the occasional Project Asset that might not meet the standards specified in the PPP Agreement, the concept of an average remaining useful life across a category of assets has been used in certain PPPs.

62.4 The PPP Agreement must accordingly provide for a procedure to be followed prior to the Expiry Date[433] in order to determine the condition of the Project Assets and whether the Private Party has complied with the obligations in relation to the condition of the assets. A procedure has to be agreed upon whereby a survey is conducted to examine the assets; a schedule is prepared which details all items that require remediation; a programme for remediation is developed; and the costs of such remediation are ascertained and inspections are held to ensure that the remediation work is properly completed.[434] As a means of ensuring that the Private Party complies with its obligations in relation to the condition of the Project Assets at the Expiry Date, it is not uncommon to require the Private Party to provide the Institution with acceptable security. This security could take the form of final bonds, reserve

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[432] Toll road projects have, for example, required that at the Expiry Date, the road be in a condition in which it could be used for at least three years, while a hospital project has required that categories of equipment have a remaining average useful life of at least one-third of the original useful life.

[433] This should still allow sufficient time to enable the necessary survey to be undertaken, a programme prepared and the remediation works, if any, in respect of such Project Assets to be completed, inspected and accepted prior to the Expiry Date.

[434] In projects where the Institution will not require the assets at Expiry Date, it may be possible to shift the Residual Value risk to the Private Party. The Unitary Payment would have to be adjusted taking into account the Residual Value of the assets at Expiry Date that the Private Party may be able to realise.

accounts or deductions from the Unitary Payment (See Part F:32 (*Services: Maintenance in General*)).

63 COMPENSATION ON TERMINATION

63.1 General

The PPP Agreement must clearly stipulate that the Institution will pay no compensation to the Private Party on expiry of the Project Term. The Private Party will seek compensation from the Institution in the event that the PPP Agreement is terminated prior to the Expiry Date. The value of compensation payable to the Private Party on an early termination will vary depending on the reason for that termination. Where the termination is a result of Institution Default, the value of the compensation payable to the Private Party is usually greater than that payable in the event of Force Majeure termination or termination as a result of a Private Party Default. The compensation payable on Private Party Default should be substantially less than the compensation payment on termination for any other reason.

63.2 Set-off

The Institution should have the right to set-off amounts due to it by the Private Party against any compensation due to the Private Party on termination for Private Party Default. This right of set-off should not be limited and there should be no ring-fencing of the Debt in these circumstances. On termination for reasons other than Private Party Default, it is acceptable for this right of set-off to be limited so that the Debt is ring-fenced and the Lenders afforded some protection.

64 COMPENSATION ON TERMINATION FOR INSTITUTION DEFAULT

In the event of termination as a result of Institution Default, the compensation payment must include the total amount outstanding in respect of the Debt, including any breakage costs as well as breakage premiums. The compensation payment also ought to cover all amounts due by the Private Party to third parties in relation to the Project, for example, Subcontractor Costs. 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 for a specified time period only. In determining the period for which the Institution should compensate the Private Party for Subcontractor losses of profits, the Institution shall take into account (i) the particular sector or industry; (ii) how soon before the Subcontractor is likely to source another project; and (iii) the expired duration of the Project Term so that the greater the unexpired portion of the Project Term, the greater the amount that the Institution should pay. Subcontractor 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 decrease.[435] As the termination is not due to any fault on the part of the Private Party, fairness dictates that the compensation include Shareholder Loans as well as a return on Equity.

64.1 **Interest Rate Risk**

64.1.1 Precisely what will be covered by "Debt" must be clearly defined.

64.1.2 Debt should cover all types of debt, save for Shareholder Loans.

64.1.3 In almost every project, interest rates will initially be stipulated in the Financing Agreements as variable rates. The standard practice is for a variable rate to be nominated, and then on or shortly before the Signature Date, the appropriate calculations to be done and an interest rate swap to be concluded so as to introduce a fixed rate. The Financial Model is then run again and the effect of this on various costs is calculated and set.

64.1.4 The bidders must, during the RFP process, demonstrate in their bids how the interest rate risk will be managed by means of hedging arrangements and how their interest rate hedging arrangements, if any, will achieve value for money. The bidders must also consider affordability when deciding on the appropriate strategy for managing the interest rate risk.

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[435] The Institution should consider this issue at the time of evaluating the bid proposals and the RFP should seek a response from the bidders in this regard.

To the extent that the employees are transferred to the Institution on termination, redundancy costs must be excluded.

64.1.5 The prescribed position is that the interest rate is the Private Party's risk. The Institution must not bear any interest rate risk either during the Project Term or in relation to its compensation obligations on certain early termination. It is standard practice for the Private Party to carry all interest rate risk. In certain types of termination it may be necessary for the Institution to compensate the Private Party for the costs associated with terminating these hedging arrangements. A distinction must be made between breakage costs, being the direct costs associated with unwinding the hedging arrangements, and breakage premiums, being the penalties payable for unwinding the hedging arrangements. In the event of termination for Institution Default, fairness dictates that the compensation payable should include breakage costs as well as breakage premiums.

64.2 **Exchange rate/currency risk**

64.2.1 All amounts provided for under the PPP Agreement should be stipulated and payable in Rands.

64.2.2 The prescribed position is that Institutions should not accept exchange rate or currency risk. This risk must be borne by the Private Party.

64.2.3 In some PPPs there may be situations that oblige Private Parties to effectively accept long-term foreign currency obligations, so that they will have to enter into currency hedging arrangements. The Lenders or hedging banks will often seek to have the Institution assume some or all of the hedging liabilities if there is an early termination of the PPP Agreement.

64.2.4 Where the Institution is a provincial government including a provincial public entity, this is not permitted. Section 67 of the PFMA provides that:

"A provincial government, including any provincial public entity, may not borrow money or issue a guarantee, indemnity or security or enter into any other transaction that binds itself to any future financial commitment, denominated in a foreign currency or concluded on a foreign financial market."

Institutions in the national government may only incur such a financial commitment if authorised or permitted to do so by the Minister of Finance (and then only up to a prescribed limit).[436]

64.2.5 As in the case of interest rate risk, the bidders must demonstrate during the RFP stage how exchange rate and currency risks will be managed and how they impact affordability.

64.2.6 The prescribed position is that Institutions should not accept any hedging liabilities, whether by guaranteeing hedging payment obligations (in Rands or any other currency) during the Project Term or by assuming some or all of the hedging obligations on early termination or by compensating for any costs of unwinding the hedge on early termination. It is standard practice for the Private Party to carry all exchange rate risk. In certain types of termination it may be necessary for the Institution to compensate the Private Party for the costs associated with terminating these hedging arrangements. A distinction must be made between breakage costs, being the direct costs associated with unwinding the swap, and breakage premiums, being the penalties payable for unwinding the swap arrangements. In the event of termination for Institution Default, fairness dictates that the compensation payable should include breakage costs as well as breakage premiums.

64.3 **Shareholder Loans/Equity**

64.3.1 Return on equity (including pure equity (that is, "Equity" as defined) and the Shareholder Loans) compensation can be calculated using several approaches:

64.3.1.1 compensation to reflect the market value of both Equity and Shareholder Loans. The purpose is to allow the Shareholders to take the full benefit of good Private Party performance but bear the risks associated with poor performance. The Institution would pay an amount for both Equity and Shareholder Loans based on their

[436] See sections 66(2)(a), 66(3)(b), 66(3)(c), 66(7)(b), 70 and 71 of the PFMA.

market value on a going concern basis immediately prior to termination, that is, the amount for which the Equity and Shareholder Loans could have been sold to a willing buyer at the relevant date (the calculation being based on the assumption that there had been no Institution Default and that both Equity and Shareholder Loans were freely transferable). The market valuation[437] will reflect the extent to which any such Project Assets are not transferred to the Institution on termination,[438] the value of anticipated future cash flows (both revenue and costs); the risk allocation under the PPP Agreement; and market appetite for contracts of a similar nature. It will also take into account the value of the Project Assets (including any cash balances) held by the Private Party at the Termination Date.

64.3.1.2 compensation to reflect the base case return on equity (Equity plus Shareholder Loans) for the entire duration of the PPP Agreement. The purpose is to provide the Shareholders with the returns they expected from the Project at the outset, regardless of actual project performance (whether better or worse than expected). The compensation payment is the amount which, when taken together with all amounts already paid in respect of Equity (by way of dividends and other distributions) and Shareholder Loans (by way of interest and principal repayments) and taking into account the actual timing of all such payments, provides the Shareholders with their base case return on equity as agreed at the Signature Date. Where the base case return on equity has already been achieved, no payment should be made; or

64.3.1.3 compensation to reflect the base case return on equity (Equity plus Shareholder Loans) for the remainder of the Project Term. This is an amalgamation of the other two approaches. The compensation

437 The South African PPP market has probably not yet reached this level of maturity.

438 This is, however, rare as in most cases the Project Assets are, to the extent that title is not already vested in the Institution, transferred to the Institution on termination as they are required for the continued provision of services.

payment is the amount of future return which the Equity and Shareholder Loans originally provided for in the base case bid. Care should be taken to ensure that if a refinancing has occurred (see Part Q: (*Refinancing*)) and the original Equity and Shareholder Loans have been reduced, there is no double counting.

64.3.2 The bidders should be instructed in the RFP to submit a mandatory bid on the basis of the second option as this is a quantifiable cost to the Institution from financial close. If the bidders wish to submit a bid on the basis of the first or third options, this should be done as an alternative bid.

Standard Clause

Compensation on Termination for Institution Default

On termination of this PPP Agreement as a result of an Institution Default, the Institution shall pay[439] *the Private Party an amount equal to the aggregate of:*

(a) an amount equal to the Debt and all fees, costs, expenses, breakage costs and breakage premiums in connection with any Financing Agreement;

(b) Subcontractor Costs; and

(c) [Equity Compensation]; and[440]

(d) redundancy payments for employees of the Private Party not transferring to the Institution that have been or will reasonably be incurred by the Private Party as a direct result of the termination of this PPP Agreement,[441]

less*, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

(i) all credit balances on any bank accounts, held by or on behalf of the Private Party on the Termination Date 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

[439] The Institution should not have the right of set-off against the compensation payments in these circumstances.

[440] This sub-Clause (c) will have to be drafted to reflect the Shareholder Loans (plus outstanding interest thereon) and Equity compensation that is agreed in terms of Section 64.3.

[441] See footnote 435 regarding the exclusion of these costs.

applied in reinstatement) and sums due and payable from the Subcontractors and any other third parties;

(ii) 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;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less liabilities 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:

(aa) 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

(bb) 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; and

(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

65 COMPENSATION ON TERMINATION FOR PRIVATE PARTY DEFAULT

65.1 Introduction

65.1.1 One question that may be asked is why compensation should be paid to the Private Party when it has defaulted. Under a typical service contract, not only would no compensation be paid but the defaulting party could also expect the innocent party to bring claims for damages. The reason that compensation is paid is that a failure to compensate could unfairly benefit the Institution. This would be the case, for example, where a particular asset is developed to deliver the Services and the Institution is entitled to have the asset transferred to it on a termination without compensating the Private Party for its value.

65.1.2 "No compensation" models have also been driven by a proper concern that, on Private Party Default, Lenders should be encouraged to step–in and rescue the Project. They do, however, expose the public sector to the charge that it is seeking a possible windfall gain in the event that termination occurs (for example, if it takes over a valuable asset), although this is refutable if the Institution agrees to pay the market value of any assets to be transferred to it. These models may also serve to increase the cost of Projects to the public sector by forcing the bidders to take a conservative approach to risk pricing, liquidated damages and the limits on liability they require from the Subcontractors.

65.1.3 The amount of compensation payable on Private Party Default termination is one of the key commercial issues for all parties concerned. The question which is then relevant is how best to assess what is an appropriate level of compensation for Private Party Default.

65.1.4 Compensation based on the NPV of future cash flows is not appropriate as the Private Party is not penalised for poor performance. Also, compensation based on NPV calculations may be sufficient to repay Debt in full and this may remove the Lenders' incentive to step-in and remedy the situation and may result in a termination, which would otherwise have been avoidable.

65.1.5 The market value approach described below represents a balance between protecting the Institution's interests and not imposing unreasonable penalties on the Private Party for its default. It also encourages the Lenders to step-in and rescue the Project instead of simply relying on the termination payment to recover their Debt (see Part O:73 (*Step-in: By the Lenders*)), while taking into account poor performance by the Private Party as this will be reflected in the price that prospective bidders would be willing to pay for the PPP Agreement.

65.1.6 The major criticism of the market value approach is that the South African PPP market is not mature enough to determine, with reasonable accuracy, the existence of a liquid market, which is an important element of the market value approach.

65.1.7 The Lenders' concerns are that the market value approach may result in a substantial portion of the Debt not being recovered. Therefore, during these developing stages of the PPP market in South Africa, these Lender concerns are catered for by providing that an agreed percentage of the Debt be repaid where, following the retendering of the Project, the Adjusted Estimated Project Value[442] pursuant to the market value approach yields an amount that is less than that percentage.

65.1.8 The market value approach is, however, still viewed as the preferable route for calculating compensation for termination due to Private Party Default. Therefore while the concerns of the Lenders in relation to the market value approach are addressed in this Standardisation by payment of an agreed percentage of the Debt, the intention of the National Treasury is, as the South African PPP market develops, to eventually move away from any Debt-based compensation in favour of the market value approach exclusively. In the interim, however, the prescribed approach in this Standardisation is for compensation due on termination for Private Party Default to be the greater of the pre-agreed percentage of the Debt and the highest tender price that is received pursuant to the Project being retendered, or the greater of the pre-agreed percentage of the Debt and the Adjusted Estimated Project Value in the case where the Project is not retendered.

65.2 **Market Value**

65.2.1 The market value approach encourages the Lenders to step-in and rescue the Project if the Private Party defaults. If the Lenders fail to do so and the PPP Agreement is terminated, the compensation will be based on the market value of the unexpired portion of the Project Term or the agreed Debt percentage.

65.2.2 The advantages of this approach are that it:

65.2.2.1 does not saddle the Lenders with the responsibility of transferring the Project when there is no market for such projects;

442 See the Standard Clause in Section 65.5 (*No Retendering Procedure*) for a definition.

65.2.2.2 allows Lenders to step-out if they have been unable to rescue the Project after stepping-in (see Part O:73 (*Step-in: By the Lenders*));

65.2.2.3 increases co-operation among the Parties and the Lenders in order to rescue the Project;

65.2.2.4 preserves the Institution's position even where Lenders do not step-in;

65.2.2.5 does not give the Institution a windfall gain on termination; and

65.2.2.6 does not discriminate against different types of finance, Equity or Shareholder Loans.

65.2.3 If the Institution notifies the Private Party of its intention to terminate the PPP Agreement, the Lenders will, in terms of the Direct Agreement,[443] have the right to prevent termination either by stepping-in and remedying the default or by having the PPP Agreement transferred to a third party if there is a liquid market. If the Lenders demonstrate in accordance with the terms of the Direct Agreement that there is no liquid market and the Institution agrees or the Independent Expert determines that the Lenders have demonstrated that there is no liquid market, then there should be no retendering by the Institution and the PPP Agreement terminates automatically.

65.2.4 If the Institution disagrees and the Independent Expert determines the dispute in favour of the Institution, then the Institution may retender the PPP Agreement. The outcome of the retender will determine the compensation payable to the Private Party (subject to any Debt floor that is agreed). However if the outcome of the retendering results in the highest tender price being less than a pre-agreed percentage of the Debt, the Private Party should not be paid the highest tender price but rather the pre-agreed percentage of the Debt.

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[443] See Part O:74 (*Step-in: Standard Direct Agreement*).

65.2.5 While the Lenders would probably accept the risk of Private Party's Default and any resultant termination, it is unlikely that they will agree to the retender of the remaining Project Term if there is no liquid market for similar types of PPPs. The market value approach caters for this probability in that if there is no liquid market pursuant to an RFQ, then the compensation is the Adjusted Estimated Project Value (subject to any Debt floor that is agreed).[444]

65.3 **Retendering Option and Liquid Market**

65.3.1 The retendering option and liquid market approach gives the Institution the flexibility of choosing whether or not to retender the PPP Agreement, following termination. This option should not be available to the Institution if the Lenders have stepped-in and have been unable to rescue the Project or "sell" the PPP Agreement because there is no liquid market for the PPP Agreement.

65.3.2 If the Institution could exercise the option under such circumstances, it would be taking advantage of there being no liquid market. In other circumstances, however, the Institution should have the right to choose whether to retender the unexpired Project Term or to have the Estimated Project Value calculated.

65.3.3 If there is no liquid market for the PPP Agreement and the PPP Agreement terminates, then the procedure set out in Section 65.5 (*No Retendering Procedure*) should be followed.

65.3.4 There will be a liquid market for the PPP Agreement if, following an RFQ issued in terms of either the PPP Agreement or the Direct Agreement if the Lenders have decided to step-in,[445] at least three bidders are pre-qualified. The Lenders should not be entitled to assert that there is no liquid market if they have not stepped-in in terms of the Direct Agreement.

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[444] See the Standard Definitions in Section 65 (*No Retendering Procedure*) for the definition of this term.

[445] See Part O: 73 (*Step-in: By the Lenders*).

65.3.5 The question is whether the market for contracts of this type in general is liquid (it is possible for there to be no bidders on retendering and there still to be a liquid market).[446] The relevant test is the state of the PPP market for similar contracts at the time when the liquid market test is run. What happens at the end of the Retendering Procedure, could very well be quite different. The apparent lack of maturity of the South African PPP market makes it difficult to ascertain the existence or not of a liquid market by means of a theoretical exercise. Given the current South African market conditions, the most feasible way of ascertaining the existence of a liquid market would be to issue an RFQ. If at least three bidders are pre-qualified pursuant to the RFQ, then it would be fair to conclude that a liquid market exists. If there is a liquid market for PPPs and the Institution elects to retender the PPP Agreement, the market will determine the market value of the PPP Agreement (that is, if there are no bidders for the retendering of the PPP Agreement the market has, by definition, determined that the market value of the PPP Agreement is less than or equal to zero). While this incentivises the Lenders to step-in in order to exercise greater control on retendering of the PPP Agreement,[447] the South African PPP market is however not mature enough for the Lenders to accept the risk of a market value that is significantly less than the Debt as the likelihood of it materialising is significant. For this reason if the retendering route is pursued, the prescribed approach is for the compensation payable to be the greater of the highest tender price received pursuant to the retendering of the Project and a pre-agreed percentage of the Debt.

65.3.6 If the PPP Agreement is retendered and a new Private Party appointed, the price for which the PPP Agreement is "sold" would be determined through a competitive bidding process (subject to any Debt floor) controlled by the Institution.

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[446] This is because the liquid market test is determined on the basis of whether any bidders have pre-qualified pursuant to an RFQ. An RFQ is issued by the Institution prior to the issue of an RFP. It is therefore possible for an RFQ to result in at least three bidders pre-qualifying (indicating a liquid market) but for the subsequent RFP not to result in the receipt of any bids. See Module 5: PPP Procurement for the differences between an RFQ and an RFP.

[447] See Part O:73 (*Step-in: By the Lenders*).

Standard Definition

*"**Agent**" means the agent of the Lenders from time to time.*

Standard Clause

<u>Compensation on Termination for Private Party Default</u>

<u>Retendering Election</u>

(a) Subject to Clause (c), the Institution shall be entitled[448] either to:

(i) retender the provision of the Services in accordance with Clause [x] (Retendering Procedure); or

(ii) require an expert determination in accordance with Clause [x] (No Retendering Procedure).

(b) Subject to Clause (c), the Institution shall notify the Private Party of its election on or before the date falling [x] days after the Termination Date.

(c) The Institution shall not be entitled to elect to retender the provision of the Services for the unexpired portion of the Project Term if the Lenders have stepped-in, and the Agent has demonstrated to the Institution that there are less than 3 (three) parties (each meeting the criteria in paragraph (a), (b) and (c) of the definition of "Substitute Private Party" in the Direct Agreement) who have pre-qualified pursuant to an RFQ issued by the Lenders for the provision of the Services for the unexpired portion of the Project Term, in accordance with the Direct Agreement.[449]

65.4 **Retendering Procedure**

65.4.1 The Institution may in the circumstances referred to in Section 65.3 (*Retendering Option and Liquid Market*) choose to retender the unexpired portion of the Project Term on its original terms and pay the proceeds of the sale (less the Institution's costs) to the former Private Party.

65.4.2 Bidders must be invited to tender on the same scope of Services and Unitary Payment as that set out in the PPP Agreement. The Institution should therefore be in the same position that it would have been in had

[448] The presumption should be in favour of a retender.

[449] The compensation payable to the Private Party in such circumstances will be determined in accordance with the procedure set out in Section 65.5 (*No Retendering Procedure*).

the PPP Agreement not been terminated, save for the tender process disruption. The Institution should not change either the scope of the Services or the Unitary Payment on retender, unless agreed with the Private Party (and the Lenders). Alternatively, the Institution may pay the Adjusted Estimated Project Value of the PPP Agreement.[450]

65.4.3 Institutions must make every attempt to obtain *bona fide* responses to the RFQ including requesting bid bonds,[451] where appropriate. The RFQ must specify the remediation works, if any, that need to be undertaken in order to remedy the Private Party Default.

65.4.4 The Unitary Payment should ensure that bids with a positive monetary value are received from prospective bidders pursuant to the RFP, particularly if termination occurs post completion of the Works.

65.4.5 The Private Party will be concerned that during the period from the termination to the date of the New PPP Agreement (as defined in the Standard Definitions below), the finance costs will escalate, the value of the Project Assets may decrease (as a result of deterioration or lack of maintenance), and the Institution will obtain some benefit or value notwithstanding that the Services are not being provided. The Institution should therefore periodically pay to the Private Party a Post Termination Service Amount[452] which should represent the value received by the Institution during this interim period. The Post Termination Service Amount can be calculated by deducting from the Unitary Payment any costs incurred by the Institution, including the costs of providing alternative services as well as any rectification costs.

65.4.6 If the term of the New PPP Agreement is the same as the unexpired portion of the Project Term, then the outgoing Private Party should not be prejudiced and any Post Termination Service Amounts paid to the Private

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[450] See Standard Definition below.

[451] The value of the bid bond will depend on the stage of the Project Term at which the PPP Agreement is terminated, for example, a higher bid bond would be required during the construction phase than late in the operations phase of the PPP Agreement.

[452] See Standard Definition below.

Party should be deducted from the final compensation payment made to the outgoing Private Party.

65.4.7 If operational reasons dictate that the New PPP Agreement should expire on the original expiry date (that is, it will have a shorter term than the unexpired portion of the Project Term) then the Post Termination Service Amount should not be deducted from the compensation paid to the Private Party.

65.4.8 The Institution will select the bid that represents best value for money. This may not necessarily be the highest bid. The Private Party should be paid compensation based on the highest-priced tender, irrespective of which bid the Institution accepts. The Institution's costs of retendering, and its costs of providing the services during the period from termination to conclusion of the New PPP Agreement, must be deducted from the highest-price tender. The difference is the adjusted highest tender price that will (if it is higher than the pre-agreed percentage of the Debt) be paid to the outgoing Private Party as compensation.

65.4.9 Neither Party should be allowed to delay the retendering process.

65.4.10 The Institution will be responsible for controlling the retendering process. The Lenders will usually by this point have decided not to exercise their step-in rights or, having exercised their step-in rights, will have been unsuccessful in remedying the default. They will nevertheless want to ensure that the tender process is conducted in a manner that will result in a fair market value for the PPP Agreement being received. This may be achieved by allowing the Lenders (through the Private Party) to appoint a third party (the "**Tender Process Monitor**") to monitor the retendering process. The Tender Process Monitor should be entitled to attend meetings, and review tender documentation and bids, but should not be entitled to require that the Institution have regard to any representation made by the Tender Process Monitor. See the diagram at the end of this Section 65 for a schematic representation of these provisions.

65.4.11 The lack of maturity of the South African PPP market has resulted in concerns on the part of the private sector, especially the Lenders, that the Debt or a significant portion thereof will not be repaid on termination as the retendering option could yield bids that do not accurately reflect the value of the Project or that result in a zero value.

65.4.12 In order to address these concerns during these developing stages of the South African PPP market, the prescribed approach in this Standardisation is to compensate the Lenders for a pre-agreed portion of the Debt if the retendering results in a tender price that is less than that pre-agreed percentage of the Debt.

65.4.13 The total Debt outstanding should not be repaid as the termination is due to Private Party Default. The Debt should be reduced in order to determine the level of compensation that the Institution should pay in this event. At the original RFP stage, the Institution must request that the bidders bid on what percentage of the Debt they believe should be repaid in the event that, on retendering, the highest tender price is less than the Debt. The Institution must take advice from its financial advisors as to what is appropriately punitive in order to determine the percentage of the Debt that should be repaid in these circumstances. The percentage of the Debt that will be repaid must be agreed by the Parties at the Signature Date and incorporated into the PPP Agreement.

65.4.14 If, following retendering of the Project, the highest tender price that is received is less than the agreed percentage of the Debt, the Institution should pay the Private Party compensation based on the agreed percentage of the Debt instead of compensation based on the highest tender price received.

65.4.15 Any compensation payable to the Private Party on termination due to Private Party Default should be net of any Post Termination Service Amounts paid to the Private Party, any amounts due to the Institution by the Private Party, the tender costs as well as any rectification costs.

Standard Definitions

*"**Adjusted Debt**" means [x][453] percent of the Debt*

***less**, to the extent it is a positive amount, the aggregate of:*

(a) any Post Termination Service Amounts paid to the Private Party to date;

(b) the Tender Costs;

(c) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date 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;

(d) 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;

(e) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities of the Private Party or the Lenders properly incurred in carrying out its obligations under this PPP Agreement as at the Termination Date or such later date as the assets and rights can be realised; provided that no account shall be taken of any liabilities and obligations of the Private Party arising out of:

(i) 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

(ii) 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; and

*(f) amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off)***,**

[453] The percentage must be agreed between the Parties at the Signature Date.

plus

the Post Termination Service Amounts (if a negative number), to the extent that it has not been directly taken into account in that Tender and the Institution is entitled to such amounts in accordance with this PPP Agreement;

*"**Adjusted Highest Tender Price**"*[454] *means the Highest Tender Price*

***less**, to the extent it is positive amount, the aggregate of:*

(a) any Post Termination Service Amounts paid to the Private Party to date;

(b) the Tender Costs; and

(c) amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off),

***plus** the aggregate of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the date that the highest-priced Tender is received;

(ii) any insurance proceeds and other amounts owing to the Private Party (and which the Private Party is entitled to retain), to the extent not included in (i); and

(iii) the Post Termination Service Amounts (if a negative number),

to the extent that:

(aa) (i), (ii) and (iii) have not been directly taken into account in that Tender; and

(bb) the Institution is entitled to such amounts in accordance with this PPP Agreement;

*"**Compensation Date**" means either:*

(a) if Clause [x] (Retendering Procedure) applies, the earlier of:

> *(i) the date that the New PPP Agreement is entered into; and*
>
> *(ii) the date on which the Institution pays the Adjusted Highest Tender Price or the Adjusted Debt, as the case may be, to the Private Party, or*

[454] This definition is only of relevance if the Institution elects (under the Retendering Procedure) to follow the no retendering procedure after it has received tenders under the retendering procedure.

(b) *if Clause [x] (No Retendering Procedure) applies, the date that the Adjusted Estimated Project Value of this PPP Agreement has been agreed or determined.*

*"**Highest Tender Price**" means the price offered by the Tenderer (if any) with the highest tender price*[455] *and, if no Tenders are received, zero;*

*"**Maximum**[456] **Unitary Payment**" means, in respect of a month or part thereof, the Unitary Payment payable during that month before any deductions under Clause [x] (Payments) but allowing for [[CPIX] indexation] under this PPP Agreement;*

*"**New PPP Agreement**" means a contract on the same terms and conditions*[457] *as this PPP Agreement*[458] *at the Termination Date, but with the following amendments:*

(a) *if this PPP Agreement is terminated prior to the Service Commencement Date, then the Scheduled Service Commencement Date shall be extended by a period to allow the New Private Party*[459] *to achieve Service Commencement on or before the extended Scheduled Service Commencement Date;*

(b) *any accrued Penalty Deductions and/or warning notices shall be cancelled;*

(c) *the term of such contract shall be a period equal to the period from the [Termination Date]*[460] *until the Expiry Date; and*

(d) *any other amendments, which do not adversely affect the Private Party;*

*"**New Private Party**" means the person who has entered or who will enter into the New PPP Agreement with the Institution;*

*"**Post Termination Penalty Deduction Amount**" means for any month or part of a month, an amount equal to the Penalty Deduction that was made from the Unitary Payment under Clause [x] (Payments) in the month immediately preceding the Termination Date, less an amount equal to any Penalty Deduction that was made for an [available place] which was unavailable at the Termination Date but which has*

455 The tender price must be bid as a lump-sum. If this were not the case then the Institution would have to fund the delay in payment of the compensation amount which is unlikely to represent value for money.

456 This will require careful consideration if there is significant third party income or usage payments.

457 The New Private Party will take over from the Private Party as counterparty under the PPP Agreement and therefore take on all existing and antecedent liabilities (except in respect of Penalty Deductions for the purposes of termination and warning notices). Any bidder will therefore conduct extensive due diligence on the Project for the purposes of correctly pricing its bid.

458 This should also include other documents entered into between the Parties, where appropriate.

459 That is, time to complete is given if termination occurs prior to Service Commencement. If termination occurs during the construction period or rectification work is required following termination, but while the New PPP Agreement is in effect, then the remaining Service Period under the New PPP Agreement may be shorter than the unexpired Service Period under the existing PPP Agreement.

460 Where the Institution will no longer require the services that make up the Services, on or shortly after the original Expiry Date, then the term of the New PPP Agreement will be reduced and so Post Termination Service Amounts will not be deducted (or added back).

subsequently become available whether as a result of the Institution incurring Rectification Costs or otherwise;[461]

*"**Post Termination Service Amount**"*[462] *means for the purposes of Clause [x] (Retendering Procedure), for the whole or any part of a month for the period from the Termination Date to the Compensation Date, an amount equal to the Maximum Unitary Payment which would have been payable in that month under this PPP Agreement had this PPP Agreement not been terminated, less the aggregate of:*

(a) *the Post Termination Penalty Deduction Amount for that month;*

(b) *the Rectification Costs incurred by the Institution in that month; and*

(c) *(where relevant), the amount by which the Post Termination Service Amount for the previous month was less than zero;*[463]

*"**Rectification Costs**" means, for the purposes of any Termination Date that occurs during the Service Period, an amount equal to the reasonable and proper costs incurred by the Institution in ensuring that the Services are available;*[464]

*"**Tender**" means any tender submitted by a Tenderer that meets the qualification criteria notified under Clause [x] (Retendering Procedure);*

*"**Tenderer**" means a tenderer who is a Suitable Substitute Private Party*[465] *having submitted a Tender that complies with the requirements of the Request for Proposal issued by the Institution in relation to the New PPP Agreement;*

*"**Tender Costs**" means the reasonable and proper costs of the Institution incurred in carrying out the Tender Process;*

*"**Tender Process**" means the process by which the Institution requests tenders from any parties interested in entering into a New PPP Agreement, evaluates the responses from those interested parties and negotiates the conclusion of a New PPP Agreement with a New Private Party, in accordance with Clause [x] (Retendering Procedure); and*

*"**Tender Process Monitor**" means a third party appointed by the Private Party under Clause [x] (Retendering Procedure).*

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[461] This is effectively adding back to the Unitary Payment any such deduction. The Rectification Costs themselves are then deducted from the Post Termination Service Amounts.

[462] This payment is made both to ensure that the Institution is incentivised to expedite the retender and that any value received by the Institution is reflected post termination.

[463] A positive Post Termination Service Amount will occur where the cost incurred by the Institution in procuring the Services itself (including rectification costs) is less than the Unitary Payment. A negative Post Termination Service Amounts will arise if the costs incurred in procuring the Services (including rectification costs) are greater than the Unitary Payment.

[464] That is, in accordance with the output specifications in the existing PPP Agreement.

[465] As defined in the Direct Agreement (see Part O:74 (*Step-in: Standard Direct Agreement*)).

Standard Clause

<u>Retendering Procedure</u>

If the Institution elects to retender the provision of the Services under Clause [x] (Retendering Election), then the following provisions shall apply:

(a) The objective of the retendering procedure shall be to establish and (subject to Clause (l)) pay to the Private Party the Highest Tender Price, as a result of the Tender Process.

(b) The Institution shall (subject to any legal requirements preventing it from doing so) use its reasonable endeavours to complete the Tender Process as soon as practicable.

(c) The Institution shall notify the Private Party of the qualification criteria and the other requirements and terms of the Tender Process, including the timing of the Tender Process, and shall act reasonably in setting such requirements and terms.

(d) The Private Party authorises the release of any information that is reasonably required as part of the Tender Process by the Institution, which the Institution would otherwise be prevented from releasing under Clause [x] (Confidentiality).

(e) The Private Party may, at its own cost, appoint a Tender Process Monitor for the purposes of monitoring and reporting to the Private Party and the Lenders on the Institution's compliance with the Tender Process and making representations to the Institution. The Tender Process Monitor will not disclose any confidential information[466] *to the Private Party, the Lenders or any other person (and shall provide an undertaking to the Institution to such effect as a condition of its appointment) but shall be entitled to advise the Private Party as to whether it considers that the Institution has acted in accordance with the Tender Process, and correctly determined the Adjusted Highest Tender Price.*

(f) The Tender Process Monitor shall be required to enter into a confidentiality agreement with the Institution in a form acceptable to the Institution and shall be entitled to attend all meetings relating to the Tender Process, and inspect copies of the tender documentation and bids, and shall make written representations to the Institution regarding compliance with the Tender Process. The Tender Process Monitor shall be required to make all representations in a timely manner as the Tender Process proceeds. The Institution shall not be bound to consider or act upon such representations but acknowledges that such representations may be referred to by the Private Party in the event that the Private Party refers a dispute relating to the

466 The Parties will agree what constitutes "confidential information" when the Tender Process Monitor is appointed.

Adjusted Highest Tender Price to dispute resolution in accordance with Clause [x] (Dispute Resolution).

(g) *For all or any part of a month, falling within the period from the Termination Date to the Compensation Date, the Institution shall pay to the Private Party:*

(i) *the Post Termination Service Amount for that month, on or before the date falling [x] Business Days after the end of that month; and*

(ii) *the Post Termination Service Amount for the period ending on the Compensation Date, on or before the date falling [x]Business Days after the Compensation Date.*

(h) *If any Post Termination Service Amount is less than zero then it shall be carried forward and shall be set off against any future positive Post Termination Service Amounts. If any such Post Termination Service Amount has not been set-off on or before the Compensation Date then it shall be taken into account in the calculation of the Adjusted Highest Compliant Tender Price.*

(i) *The Institution shall require bidders to bid on the basis that they will receive the benefit of any insurance proceeds or any outstanding claims under material damage insurance policies*[467] *on the date that the New PPP Agreement is entered into.*

(j) *As soon as practicable after tenders have been received, the Institution shall (acting reasonably) evaluate the Tenders and shall notify the Private Party of the Adjusted Highest Tender Price.*

(k) *If the Private Party refers a dispute relating to the Adjusted Highest Tender Price to dispute resolution in accordance with Clause [x] (Dispute Resolution), the Institution shall nevertheless be entitled to enter into a New PPP Agreement.*[468]

(l) *Within [x] Business Days after the Adjusted Highest Tender Price has been determined, the Institution shall pay to the Private Party, the greater of:*

(i) *the Adjusted Debt; and*

(ii) *the Adjusted Highest Tender Price.*

(m) *The discharge by the Institution of its payment obligation in Clause (l) above shall be in full and final settlement of all the Private Party's claims and rights against the Institution for breaches and/or termination of this PPP Agreement and the Project Documents*[469] *whether under contract, delict or*

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[467] This will be for the purposes of carrying out any reinstatement works.

[468] If there is an agreed amount and a disputed amount then the Institution should only be entitled to retain the disputed amount.

[469] Any other relevant contract should also be included here.

otherwise, save for any liability of the Institution which arose prior to the Termination Date that has not already been taken into account in determining the Adjusted Highest Tender Price or the Adjusted Debt (as the case may be).

(n) *Subject to Clauses (o) and (q) below, if the Institution has not paid an amount equal to the Adjusted Highest Tender Price or the Adjusted Debt in terms of Clause (l) to the Private Party on or before the date falling 2 (two) years after the Termination Date then the provisions of this Clause shall not apply to that termination and the provisions of Clause [x] (No Retendering Procedure) shall apply instead.*

(o) *If each of the Adjusted Debt and the Adjusted Highest Tender Price is zero or a negative number then the Institution shall have no obligation to make any payment to the Private Party and with effect from the time that the Institution gives notice of such determination to the Private Party, the Institution shall be released from all liability to the Private Party for breaches and/or termination of this PPP Agreement and any other Project Document whether under contract, delict or otherwise save for any liability of the Institution which arose prior to the Termination Date that has not already been taken into account in determining the Adjusted Highest Tender Price or Adjusted Debt.*

(p) *The Institution may elect at any time prior to the receipt of a Tender to follow the no retendering procedure under Clause [x] (No Retendering Procedure) by notifying the Private Party that this election has been made.*

(q) *If the Institution receives a Tender but decides not to complete the Tender Process, it shall notify the Private Party of this decision and pay to the Private Party an amount equal to the greater of the Adjusted Highest Tender Price and the Adjusted Debt within [x] Business Days of such notification.*

65.5 **No Retendering Procedure**

65.5.1 In the event that there is no liquid market or the Institution elects not to retender the PPP Agreement the Adjusted Estimated Project Value should be calculated. Ideally this should be the amount paid to the Private Party in such event. As in the case of retendering, the lack of maturity of the South African PPP market has resulted in concerns on the part of the private sector, especially the Lenders, that the Debt or a significant portion thereof will not be repaid on termination.

65.5.2 In order to address these concerns during these developing stages of the South African PPP market, the prescribed approach in this

Standardisation is to compensate the Lenders for a pre-agreed portion of the Debt if the Adjusted Estimated Project Value is less than that pre-agreed percentage of the Debt.

65.5.3 The total Debt outstanding should not be repaid as the termination is due to Private Party Default. The Debt should be reduced in order to determine the level of compensation that the Institution should pay in this event. At the original RFP stage, the Institution must request that the bidders bid on what percentage of the Debt they believe should be repaid in the event that the Adjusted Estimated Project Value is less than the Debt. The Institution must take advice from its financial advisors as to what is appropriately punitive in order to determine the percentage of the Debt that should be repaid in these circumstances. The percentage of the Debt that will be repaid must be agreed by the Parties at the Signature Date and incorporated into the PPP Agreement.

65.5.4 If the Adjusted Estimated Project Value is less than the agreed percentage of the Debt, the Institution should pay the Private Party compensation based on the agreed percentage of the Debt instead of compensation based on the Adjusted Estimated Project Value.

65.5.5 Any compensation payable to the Private Party on termination due to Private Party Default should be net of any Post Termination Service Amounts paid to the Private Party, any amounts due to the Institution by the Private Party, the costs associated with the calculation of the estimated project value as well as any Rectification Costs.

65.5.6 In calculating the Adjusted Estimated Project Value, the full Unitary Payment is forecast from the date of termination to the Expiry Date (ignoring any Penalty Deductions) and the estimated costs to the Institution of delivering the Services to the standard required in the PPP Agreement (including maintenance costs, refurbishment costs and rectification costs) are then deducted.

65.5.7 The first point to consider is whether this calculation should be conducted in nominal terms (that is, using current prices) or in real terms (that is, using constant prices). For contracts with 100% indexation to CPIX it should not normally matter since both methods would achieve the same result. However, the advantages of conducting the analysis in nominal terms are the following:

65.5.7.1 many elements of a project (including tax and cost of funds) are quoted in nominal terms. It is therefore easier to use the same base; and

65.5.7.2 the "real" value of the Unitary Payment effectively declines with time. The effect of indexation must therefore be recognised by explicitly including the indexation effects and conducting the analysis in nominal terms.

65.5.8 If the forecast cash flows are expressed in nominal terms (that is, taking indexation into account), the discount rate used must also be expressed in nominal terms. The discount rate is usually made up of a "real" rate of return to which an allowance for inflation is added. A methodology for making this adjustment is set out in the Standard Clause below.

65.5.9 The Institution and the Private Party will need to agree on a forecast rate of inflation to make the nominal calculations. The agreed assumed rate of inflation should be the South African Reserve Bank's target long-term inflation rate as published by the South African Reserve Bank.[470]

65.5.10 The Estimated Project Value analysis should be conducted in pre-tax terms.

65.5.11 The forecast cash flows should be discounted at the "Termination Date Discount Rate" (as defined in the Standard Definitions below), which reflects the risk of the underlying cash flow by using the real pre-tax project internal rate of return reflected in the base case Financial Model. Since underlying rates in the market, such as the real yields on government bonds, can and do vary over time, the formula for the

[470] This is a CPIX target.

Termination Date Discount Rate takes into account the effect of changes to these underlying variables.

65.5.12 The main argument in favour of giving effect in the discount rate to changes in underlying risk-free rates is that if a liquid market existed and the PPP Agreement were successfully retendered, a hypothetical bidder would take into account current market yields on risk-free investments in choosing what discount rate to apply to the Project. If these benchmark rates had moved upwards, for instance, in the time between Signature Date and Termination Date, an incoming bidder would bid a lower sum for the Project and vice versa. Not recognising this difference could create a discrepancy between the compensation sums arising out of the Retendering Procedure and the No Retendering Procedure. It is therefore recommended that an adjustment should be made as suggested in the drafting below to reflect the impact on the Termination Date Discount Rate of changes to underlying market rates.

65.5.13 An adjustment as proposed below provides the Private Party with a natural hedge against movements in underlying market rates that may cause losses or profits on broken interest rate hedges on termination. If interest rates move down between the Signature Date and Termination Date, the Private Party would find itself having to pay positive breakage costs on the interest rate swap (if one was put in place at Signature Date). Adjusting the Estimated Fair Value discount rate downwards in line with market rate movement would have the effect of generating a larger compensation sum, thereby partially or fully protecting the Private Party against the adverse position on its interest rate swap. Upward movements in interest rates would likewise have the opposite effect, generating profits on the broken hedge but a smaller compensation sum from the Institution.

65.5.14 From the point of view of Institutions, it is also beneficial to consider adjustments as suggested below to the discount rate because, just as the adjustment provides the Private Party with a natural hedge against breakage costs, it provides Institutions with a natural hedge against the cost of funding compensation payments. To illustrate, an upward movement in interest rates would make it more expensive for Institutions to finance a given compensation payment, but the proposed mechanism would adjust the discount rate upward in line with market movement and reduce the amount of compensation to be paid, thereby partly protecting the Institution's position. A downward movement in market rates would have the opposite effect.

65.5.15 Any dispute as to the assessed value of the terminated PPP Agreement should be dealt with through the dispute resolution procedure.

65.5.16 If the Adjusted Estimated Project Value is less than the pre-agreed percentage of the Debt, then the Institution should pay the Private Party the pre-agreed percentage of the Debt.

Standard Definitions

*"**Adjusted Estimated Project Value**" means the Estimated Project Value of the PPP Agreement*

***less** the aggregate of:*

(a) [the Post Termination Service Amounts[471] (if a positive number);[472]]

(b) the Calculation Costs; and

(c) amounts that the Institution is entitled to set off or deduct under Clause [x] (Set-Off),

***plus** the aggregate of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the date that the Estimated Project Value of the PPP Agreement is calculated;[473]

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471 There will only be any Post Termination Service Amounts here to the extent that the Institution starts the retendering process, but then decides to follow the no retendering approach.

472 These amounts are not deducted to the extent that the period in (c) of the Standard Definition of "New PPP Agreement" is a period from the date of the New PPP Agreement to the original Expiry Date (rather than the Termination Date to the original Expiry Date).

473 In reality, on Private Party Default (i) and (ii) are likely to be the same amounts.

(ii) any insurance proceeds,[474] and other amounts owing to the Private Party (and which the Private Party is entitled to retain), to the extent not included in (i); and

(iii) the Post Termination Service Amounts (if a negative number),

to the extent that:

(aa) (i), (ii) and (iii) have not been directly taken into account in calculating the Estimated Project Value; and

(bb) the Institution has received such amounts in accordance with this PPP Agreement;

*"**Calculation Costs**" means the total of all costs forecast to be incurred by the Institution as a result of termination, which shall be calculated and discounted at the Termination Date Discount Rate and deducted from the payment calculated pursuant to sub-Clause (b) in the definition of Adjusted Estimated Project Value above, such costs to include (without double counting):*

(a) a reasonable risk assessment of any cost overruns that will arise,[475] whether or not forecast in the relevant base case;

(b) the costs of the Services forecast to be incurred by the Institution to the standard required[476]; and

(c) any rectification costs required to deliver the Services to the standard required (including any costs forecast to be incurred by the Institution to complete construction or development work and additional operating costs required to restore operating services standards),

in each case such costs to be forecast at a level that will deliver the Services in accordance with the output specifications;

*"**Deemed New PPP Agreement**" means a contract on the same terms and conditions as this PPP Agreement, as at the Termination Date, but with the following amendments:*

(a) if this PPP Agreement is terminated prior to the Service Commencement Date, then the Service Commencement Date shall be extended by a period to allow a New Private Party[477] to achieve Service Commencement;

(b) any accrued Penalty Deductions shall be cancelled; and

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474 This shall exclude the proceeds in terms of any material damage insurance. See Part I: (*Insurance*).

475 A methodology can be agreed in advance for agreeing what constitutes a reasonable risk assessment.

476 This includes both the everyday running costs and the costs of the service and life-cycle maintenance costs. Forecasts are determined by agreement or, in the event of disputes, by an expert. See Section 68 (*Termination Calculation Expert*).

477 That is, time to complete is given if termination occurs prior to Service Commencement. Other timing-related issues may require similar treatment depending on the PPP Agreement.

(c) the term of such contract shall be for a period equal to the term from the Termination Date[478] to the Expiry Date;

*"**Estimated Project Value**" means the amount determined in accordance with Clause [x] (No Retendering Procedure) that a third party would pay to the Institution as the market value of the Deemed New PPP Agreement;*

*"**Termination Date Discount Rate**" means a discount rate expressed as:*

[(1+ Real Base Case Project IRR + Bond B – Bond A) (1+ i) – 1]*

where:

*"**i**" is the agreed assumed forecast rate of increase in the South African Reserve Bank's prevailing long-term inflation target;*

*"**Bond A**" is the real yield to maturity on a benchmark government bond instrument of the same or closest possible maturity as the average life of the Debt as at the Signature Date;*

*"**Bond B**" is the real yield to maturity on a benchmark government bond instrument of the same or closest possible maturity as the average life of the Debt as at the Termination Date; and*

*"**Real Base Case Project IRR**" means the real pre-tax Project internal rate of return[479] as set out in the Financial Model.[480]*

Standard Clause

<u>No Retendering Procedure</u>

If either the Institution is not entitled to retender pursuant to Clause [x] (Retendering Election) or the Institution elects to require an expert determination by the Termination Calculation Expert[481] in accordance with this Clause [x] (No Retendering Procedure) then the following procedure shall apply:

(a) Subject to Clause (b) below, the Private Party shall not be entitled to receive any Post Termination Service Amount.

(b) If the Institution elects to require an expert determination in accordance with this Clause [x] (No Retendering Procedure) after it has elected to follow the procedure under Clause [x] (Retendering Procedure), then the Institution shall continue to pay to the Private Party each Post Termination Service Amount

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478 The Termination Date here is the relevant date as no New PPP Agreement is actually being entered into.

479 This is the Shareholders' pre-tax return. This is calculated after any taxes due by the Private Party have been deducted.

480 Parties should not agree on a discount rate other than this (this is the discount rate contained in the Financial Model).

481 See Section 68 (*Termination Calculation Expert*) for a definition.

until the Compensation Date, in accordance with Clause [x] (Retendering Procedure).

(c) In determining the Adjusted Estimated Project Value the Parties shall procure that the Termination Calculation Expert will be obliged to follow the principles set out below:

(i) all forecast amounts should be calculated in nominal terms at current prices, recognising the adjustment for [CPIX] in respect of forecast inflation between the date of calculation and the forecast payment date(s) as set out in this PPP Agreement; and

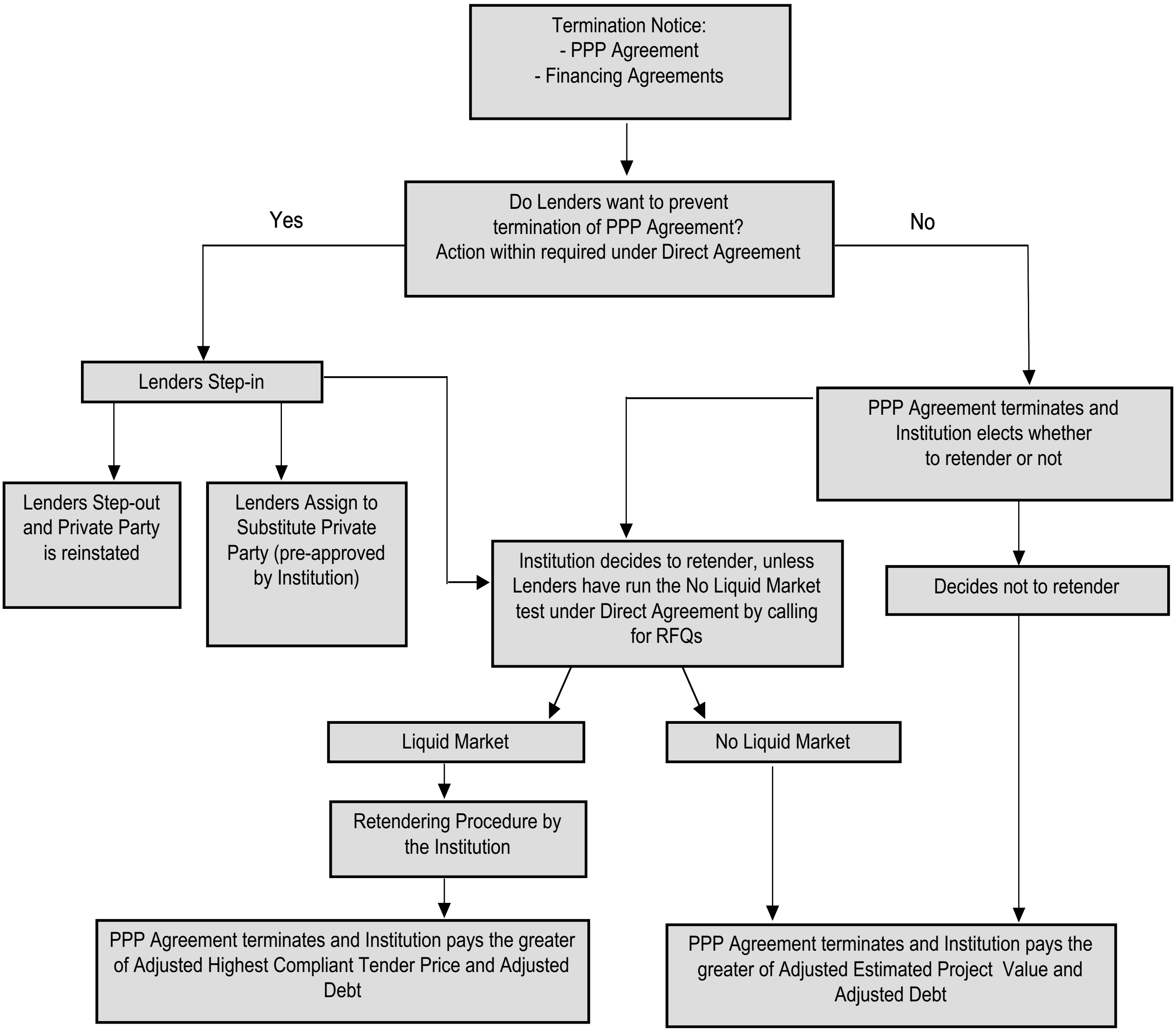
(ii) the total of all future payments of the full Unitary Payments (without Penalty Deductions) forecast to be made shall be calculated and discounted to the Termination Date at the Termination Date Discount Rate.

(d) If the Parties cannot agree on the Adjusted Estimated Project Value on or before the date falling 30 (thirty) days after the date on which the Termination Calculation Expert has determined such value, in accordance with this Clause [x] (No Retendering Procedure), then the Estimated Project Value shall be determined in accordance with Clause [x] (Dispute Resolution).

(e) The Institution shall pay to the Private Party an amount equal to the greater of the Adjusted Debt and the Adjusted Estimated Project Value on the date falling [x] days after the date on which the Adjusted Estimated Project Value has been agreed or determined in accordance with this Clause [x] (No Retendering Procedure).

(f) The discharge by the Institution of its obligation in Clause (e) shall be in full and final settlement of all the Private Party's claims and rights against the Institution for breaches and/or termination of this PPP Agreement or any Project Documents whether in contract, delict, restitution or otherwise save for any liability that arose prior to the Termination Date (but not from the termination itself) that has not been taken into account in determining the Adjusted Estimated Project Value.

PRIVATE PARTY DEFAULT



66 COMPENSATION ON TERMINATION FOR FORCE MAJEURE

66.1 Force Majeure events are events that occur through no fault of either Party. Accordingly, the compensation payable on termination as a result of Force Majeure should reflect the no-fault principle with the consequences of an event of Force Majeure being shared by the Parties. This would mean that the compensation payable in the event of Force Majeure termination should be somewhere between the compensation payable on termination for Institution Default and the compensation payable on Private Party Default.

66.2 On payment of compensation in the event of Force Majeure termination, the Institution should be entitled to deal with the Project Assets (or what remains of them) in any manner it deems feasible.

Standard Clause

<u>Compensation on Termination for Force Majeure</u>

On termination of this PPP Agreement under Clause [x] (Termination for Force Majeure), the Institution shall pay to the Private Party the aggregate of:

(a) an amount equal to the Debt and all fees, costs, expenses, breakage costs and breakage premiums in connection with any Financing Agreement;

(b) the Subcontractor Costs;

(c) an amount equal to the Shareholder Loans less any interest on the Shareholder Loans already paid to the Shareholders;

(d) an amount equal to all amounts paid to the Private Party in respect of Equity less dividends and other distributions already paid to the Shareholders; and

(e) redundancy payments for employees of the Private Party not transferring to the Institution that have been or will be reasonably incurred by the Private Party as a direct result of the termination of this PPP Agreement;

***less**, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date 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;

(ii) 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;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities 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:

(aa) 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

(bb) 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; and

(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

If the aggregate of the amounts referred to above is less than zero, then, for the purposes of the calculation in this Clause the aggregate shall be deemed to be zero.

67 COMPENSATION ON TERMINATION FOR CORRUPT ACTS

67.1 If the Institution wants the right to terminate the PPP Agreement for Corrupt Acts,[482] then it should accept an obligation to pay compensation equal to the Debt, unless the Corrupt Act is attributable to a Lender.

67.2 The exclusion of the Debt in cases where a Lender commits the Corrupt Act should be acceptable to the Lenders, as the remaining Lenders will first have the opportunity to avoid the termination of the PPP Agreement by terminating

[482] See also Section 60.5 (*Termination for Corrupt Acts*).

the involvement of the Corrupt Lender in the financing arrangements for the Project.[483]

67.3 The exclusion of the Equity and the Shareholder Loans should be acceptable to the Shareholders where a Shareholder commits the Corrupt Act. It should also be acceptable to the Shareholders where the Corrupt Act is committed by the Private Party since the Shareholders must accept the risks associated with their relationship to the Private Party, which is reflected in their expectations of a greater return.

67.4 This approach should also be acceptable where the Corrupt Act is committed by a Subcontractor or an employee of a Shareholder, the Private Party or a Subcontractor acting of its or his or her own accord, as the Private Party and the Shareholders will first have the opportunity to replace the offending Subcontractor or employee and thereby avoid the termination of the PPP Agreement.

67.5 On termination of the PPP Agreement as a result of Corrupt Acts, the Institution's only obligation should be to pay the compensation, if any, and, in addition, it should retain the right to deal with the Project Assets as it deems fit.

Standard Clause

Compensation on Termination for Corrupt Acts

(a) On termination of this PPP Agreement in accordance with Clause [x] (Termination for Corrupt Acts), the Institution shall, subject to Clause (b), pay the Private Party an amount equal to:

the Debt;

less*, to the extent it is a positive amount, the aggregate, as at the Termination Date, of:*

(i) all credit balances on any bank accounts held by or on behalf of the Private Party on the Termination Date and the value of any right of the Private Party or its Lenders to receive insurance proceeds and of any such proceeds actually received by them

[483] The Corrupt Lender's involvement in the financing arrangements for the Project must be terminated in all respects, including for instance in the security arrangements for the Project or (if applicable) as the Lenders' Agent. This will also entail that the remaining Lenders take up the Corrupt Lender's share of any undrawn financial commitments and the Debt or, if and to the extent they are unable to do so, assign such commitments and Debt to other Qualifying Financial Institutions.

(save where such credit balances or insurance proceeds are paid to the Institution and/or are to be applied in reinstatement) and sums due and payable from Subcontractors and any other third parties;

(ii) 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;

(iii) the market value of any other assets and rights of the Private Party or the Lenders (other than those transferred to the Institution pursuant to this PPP Agreement) less the liabilities 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:

(aa) 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

(bb) 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; and

(iv) amounts that the Institution is entitled to set off and deduct under Clause [x] (Set-off).

If the aggregate of the amounts referred to above is less than zero, then, for the purposes of the calculation in this Clause the aggregate shall be deemed to be zero.

(b) If the termination is as a result of a Corrupt Act on the part of any of the Lenders, then the amount payable by the Institution shall be zero.

68 TERMINATION CALCULATION EXPERT

68.1 If any forecast or calculation is required to be made for the purposes of determining an amount payable by one Party to the other pursuant to Section 63 (*Compensation on Termination*) to Section 67 (*Compensation on Termination for Corrupt Acts*) it should be made by a recognised firm of accountants or other independent experts (the "**Termination Calculation Expert**") appointed by the Parties, or in the absence of agreement, by an independent and willing expert third party such as the President of the South African Institute of Chartered Accountants.[484]

68.2 Each forecast or calculation to be made by the Termination Calculation Expert should be made in accordance with prevailing best market practice. In preparing any forecast or calculation the Termination Calculation Expert will:[485]

68.2.1 be entitled to amend the input parameters contained in the Financial Model to the extent that the Termination Calculation Expert, acting reasonably and having taken appropriate specialist and technical advice from a panel of persons having practical experience in the requisite field, considers that such input parameters do not properly reflect the most likely outcome for the matters which are the subject of such input parameters; and

68.2.2 otherwise utilise the methodology employed in the Financial Model.

69 AUTHORISATION OF PAYMENTS

Institutions are bound by the provisions in chapter 8 of the PFMA requiring particular authorisations for various financial commitments. Institutions must obtain legal advice as to whether these compensation payments are covered by that chapter. Whatever this advice may be, Private Parties and their funders may prefer to have the necessary authorisations given as if these payments do fall within that chapter. See Part H:37 (*Payment and Financial Matters: Unitary Payments*).

70 PAYMENT PROCEDURE

70.1 Where an incoming Private Party pays market value on Private Party Default termination, or the PPP Agreement is terminated for Institution Default, the Institution should pay the Private Party by way of a lump-sum.

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[484] At the Signature Date, the Parties must agree the procedure for the selection and appointment of the expert as well as the terms of reference for the expert and who will be liable for payment of the expert's fee.

[485] See Section 65.5 (*No Retendering Procedure*).

70.2 On other types of termination, the PPP Agreement should deal with how compensation is paid. Value for money issues should be taken into consideration, which in most cases will mean that compensation payments by lump-sum will be the appropriate position. Value for money is unlikely to be achieved if the Institution repays such amounts over time (that is, in instalments), as interest will continue to accrue on the compensation amount so as to reflect the Shareholders' and Lenders' loss of opportunity.

70.3 While the above is the general position, the Institution may wish to reserve the option to pay over a period of time due to affordability constraints. In such event, the following will apply:

70.3.1 The Private Party will require the Institution to pay interest on any outstanding balance. The interest rate must be agreed by the Parties on termination, provided that the Institution should not agree to a rate that is higher than the non-default interest rate under the Financing Agreements. If Equity or Shareholder Loan compensation is also payable on termination, the prescribed approach is for the Institution's right to pay by instalments to be restricted to the Debt-related compensation.

70.3.2 If the PPP Agreement is terminated for Private Party Default and the Adjusted Estimated Project Value is payable to the Private Party as compensation, the appropriate interest rate payable on the outstanding balance should again not be higher than the non-default interest rate under the Financing Agreements.[486]

70.3.3 If the Institution elects to pay compensation in instalments that mirror the repayment schedule under the Financing Agreements, both in terms of scheduling as well as amounts, the protections in the PPP Agreement in respect of payment default and unauthorised transfer of the PPP Agreement by the Institution should continue to operate. However, the Private Party should only have the ability to declare all outstanding

[486] Although the Adjusted Estimated Project Value may be greater than amounts owing to the Lenders, the PPP Agreement will have terminated for reasons that the Private Party can control. In such circumstances, it is equitable for the Shareholders to accept that, to the extent that the Adjusted Estimated Project Value is greater than the outstanding Debt, interest will accrue on all outstanding amounts at the non-default interest rate under the Financing Agreements.

instalments immediately due and payable on the occurrence of these events. If the Institution elects to pay compensation in instalments, the Lenders should not require the Institution to enter into new funding arrangements.

71 OTHER RIGHTS AND REMEDIES

No Party will have any rights or remedies against any other Party arising on termination save for the rights and remedies specified in the PPP Agreement. The Lenders will obtain benefits that should be specified in a Direct Agreement. In some cases the Parties may wish to provide for those benefits in the PPP Agreement using the mechanism recognised in South African Law under the description "*stipulatio alteri*".[487]

[487] See footnote 488.

PART O: STEP-IN

72 BY INSTITUTION

72.1 Introduction

72.1.1 The Institution may want the right to take urgent action in respect of the Services to avert a serious threat to an essential public concern (such as public health, safety of persons and/or property, national security or the environment) or to discharge a statutory duty. The need for this right may be due to matters outside the Project or due to a breach by the Private Party of its obligations under the PPP Agreement.

72.1.2 This right is commonly referred to as "step-in" as it involves the Institution taking over some or all of the Private Party's obligations for a period. Institution step-in, however, is not comparable to Lenders' step-in, which is usually achieved through a separate "Direct Agreement" among the Institution, the Private Party and the Lenders.[488] This is because the Institution step-in is a narrowly tailored remedy involving the Institution stepping-in for a short period to resolve an urgent problem and, upon resolution thereof to its satisfaction, "stepping-out". If the problem in question entails a long-term indefinite step-in with a possibility of no step-out, then the appropriate remedy for the problem is not step-in, but termination.

72.1.3 The period of the step-in will depend on the circumstances necessitating it. Typically though, the period might last a few hours, several days or even a few weeks.

72.1.4 Institution step-in is not appropriate for every PPP. It is only appropriate in relation to projects involving or impacting on essential core Institution services (such as a hospital project, a road transport project or a prison

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[488] In theory, the Lenders' step-in could also be achieved by inserting the legal mechanism of "*stipulatio alteri*" (that is, a stipulation in favour of another) in the PPP Agreement itself, which avoids the need for a Direct Agreement between the parties granting a right and a beneficiary of that right. In this regard see Section 73 (*Step-in: By the Lenders*). However, where the procedures required to give effect to such step-in are complex (as will often be the case), it may be more practical to do so in a Direct Agreement.

project), and then only to the extent that a failure to step-in may seriously threaten an essential public concern or result in a material breach of a statutory duty.

72.1.5 Further, Institution step-in should be in the sole and absolute discretion of the Institution. The Institution should never be obligated to do so.

72.2 **Step-in without Private Party Breach**

72.2.1 If the need for Institution step-in does not arise because of a breach by the Private Party of its obligations to deliver the Project Deliverables, then the Private Party should be relieved from the performance of those obligations in respect of which step-in is sought.

72.2.2 Further, the Institution should pay for those Project Deliverables in respect of which step-in is sought as if they had been fully available and performed by the Private Party; provided that the Private Party should not be relieved from performing any Project Deliverables that are unaffected by the Institution step-in. Accordingly, if the Private Party fails to perform any Project Deliverables that are unaffected by the Institution step-in, then Penalty Deductions should be made in respect of any such failure.

72.2.3 If, however, the Institution step-in is effected in a manner which interrupts the ability of the Private Party to perform any part of the Project Deliverables that are not included in the Institution step-in, then the Institution should continue to make full payment in respect of the interrupted Project Deliverables.

72.2.4 In addition, the Institution should indemnify the Private Party to the extent that the Private Party suffers any direct losses as a result of the Institution carrying out the step-in in a way that does not meet with the standards of Good Industry Practice. The liability of the Institution under this indemnity should be subject to the limitations in Part C:10 (*General Obligations: Double Recovery and Mitigation*).

72.3 **Step-in on Private Party Breach**

72.3.1 If a breach by the Private Party of its obligations under the PPP Agreement gives rise to any of the circumstances described in Section 72.1.1 and the need for Institution step-in, then the Institution step-in should be at the expense of the Private Party and the Institution should be permitted to do this without giving the Private Party the opportunity to remedy the breach, although the Institution must notify the Private Party of the breach.

72.3.2 Here, the Institution should continue to pay the Private Party the Unitary Payments to which it is entitled (notwithstanding the Institution step-in) *less* any Penalty Deductions but only for those aspects of the Project Deliverables that are affected by the breach, as well as deductions for any costs incurred by the Institution in stepping-in in such circumstances (such costs should extend to the cost of the work, the cost of appointing third parties to perform the work, and the time spent in relation to the step-in). If the Private Party breach also gives rise to losses for which the Institution is indemnified (for example, death or personal injury, loss of or damage to property, and so forth) then the Institution should also seek recovery under those indemnities.

72.3.3 If the breach amounts to a Private Party Default and persists after the Institution has stepped-out, then the Institution should be entitled to terminate the PPP Agreement for Private Party Default, subject to the provisions of the PPP Agreement regarding termination (including any remedy period) and the rights of the Lenders under the Direct Agreement. Given that the Unitary Payments may be subject to Penalty Deductions as a result of the Private Party Default, and given the impact of this on debt service, the PPP Agreement should also compel the Institution to trigger the Private Party Default regime (including the remedy procedures) by the expiry of the step-in period specified in the notice if the Private Party Default persists.

72.4 **Access**

The Institution must ensure that the PPP Agreement makes adequate provision for any access the Institution may need to the Project Site and the Facilities in exercising its step-in rights.

Standard Clause

<u>Institution Step-in</u>

(a) If the Institution reasonably believes that it needs to take any action in connection with the Project Deliverables because a serious and urgent risk arises [to the health or safety of persons or property, or to the environment, or to national security] and/or to discharge a statutory duty, then the Institution shall be entitled to take action in accordance with the following provisions.

(b) If pursuant to Clause (a) the Institution wishes to take action, it shall as soon as possible after reaching its determination to do so notify the Private Party in writing of:

(i) the action it wishes to take;

(ii) its reasons for taking such action;

(iii) the date when it wishes to commence such action;

*(iv) the time period (the "**Step-in Period**") which it reasonably believes will be necessary for such action and which must be a fixed period; and*

(v) to the extent practicable, the effect of such action on the Private Party and its obligations to perform the Project Deliverables during the Step-in Period.

*(c) Following the service of such notice, the Institution shall take such action as notified under Clause (b) and any ancillary action as it reasonably believes is necessary (the "**Necessary Action**") and the Private Party shall give all reasonable assistance to the Institution in the conduct of such Necessary Action.*

(d) If the Private Party is not in breach of any of its obligations under this PPP Agreement in respect of which the Necessary Action is proposed to be taken, then for so long as and to the extent that the Necessary Action is taken, and this prevents the Private Party from providing any part of the Project Deliverables:

(i) the Private Party shall be relieved from such obligations; and

(ii) in respect of the time period over which such Necessary Action is conducted and provided that the Private Party provides the Institution with such reasonable assistance as the Institution may need in the conduct of such Necessary Action (such assistance, however, to be at the expense of the Institution to the extent of any

incremental costs), the Unitary Payments due from the Institution to the Private Party shall equal the amount the Private Party would have received if it was satisfying all its obligations affected by the Necessary Action in full over such period.

(e) If the Required Action is taken as a result of a breach by the Private Party of any of its obligations under this PPP Agreement, then for so long as and to the extent that such Necessary Action is taken and this prevents the Private Party from performing any of its obligations:

(i) the Private Party shall be relieved from such obligations; and

(ii) in respect of the period in which the Institution is taking such Necessary Action, the Unitary Payments due from the Institution to the Private Party shall equal the amount the Private Party would have received if it were performing the obligations affected by the Necessary Action in full over such period, less any Penalty Deductions in respect of that breach as calculated in accordance with the payment mechanism in this PPP Agreement, and less an amount equal to the Institution's costs of taking such Necessary Action;

provided that, if by the expiry of the Step-in Period, the breach still subsists and if it constitutes a Private Party Default, then the Institution must serve a notice in terms of Clause [x] (Institution's Options) requiring the Private Party to remedy the Private Party Default or to put forward a remediation programme.[489]

73 BY THE LENDERS

73.1 Introduction

73.1.1 The main purpose of the Lenders' step-in is to ensure the continuity of the Project if the Private Party defaults under the PPP Agreement or the Financing Agreements.[490] The concern of the Lenders here is that they have financed the Project in reliance primarily on the Unitary Payments under the PPP Agreement and thus, if the PPP Agreement is terminated for Private Party Default, their security (typically, cessions and security over the bank accounts of the Private Party, the Project Documents and certain other Project Assets (excluding the Institution Assets)) will be insufficient to service the Debt.

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[489] The cross-reference is to Clause (b)(ii) of the Standard Clause (*Institution's Options*) in Part N:60.3.3 (*Termination: Termination for Private Party Default*).

[490] Typically, the Financing Agreements will include a "cross-default" provision pursuant to which a Private Party Default will trigger a default under the Financing Agreements.

73.1.2 The Lenders will not have any security interest in the Institution Assets. Depending on the Institution's own requirements, the Lenders may not have security over all or even a substantial portion of the remaining Project Assets.[491] Although the Lenders will often seek corporate guarantees or some other support from the Shareholders or their Affiliates, this support will often be restricted to narrow circumstances or limited to the early phases of the Project when capital expenditure needs and the Project risks are greater.

73.1.3 Accordingly, if the Private Party defaults under the PPP Agreement (thereby triggering a cross-default under the Financing Agreements) or if the Private Party defaults under the Financing Agreements and the repayment of the Debt is accelerated, the Lenders' security may be insufficient to recover the Debt in full. In light of this, the Lenders will typically seek the Institution's agreement to the continuation of the Project (at the Lenders' election) if such a default occurs.

73.2 **Direct Agreement**

73.2.1 A "**Direct Agreement**" as referred to in this Standardisation is an agreement among the Institution, the Lenders (usually represented by an agent) and the Private Party, which creates a mechanism for the continuation of the Project following a threatened termination of the PPP Agreement and the Financing Agreements.

73.2.2 In simple terms, the advantage of a Direct Agreement for the Institution, is the continuity of the Project Deliverables and, for the Lenders, the continuity of the cash flows of the Project that are required to service the Debt.

73.2.3 The key issues are:

73.2.3.1 when the Lenders should be permitted to step-in;

[491] See Part G: 36 (*Project Assets: Security Over Project Assets*).

73.2.3.2 the extent to which the Lenders should be obliged to assume liabilities of the Private Party; and

73.2.3.3 the extent to which the Lenders will be given the opportunity to rectify Private Party Defaults.

73.3 **Prescribed Approach**

73.3.1 The prescribed approach to the step-in rights of the Lenders is based on the following main principles:

73.3.1.1 the Lenders' step-in is voluntary;

73.3.1.2 the Institution must be no "worse off" under the step-in arrangements, that is, the PPP Agreement must continue to be performed in accordance with its terms (including, without limitation, those provisions relating to the accrual of Penalty Deductions save as provided in Section 73.4 (*Accrual of Penalty Deductions*)) as if the Private Party was performing under the PPP Agreement;

73.3.1.3 the Lenders election to step-in may only be exercised after the Institution has informed the Lenders of all outstanding liabilities due and payable by the Private Party to the Institution and all Private Party Defaults that must be remedied;

73.3.1.4 the Lenders may only exercise their step-in rights upon payment of all such liabilities to the Institution;

73.3.1.5 the Lenders must provide and implement, during an agreed step-in period, a remedial programme, reasonably satisfactory to the Institution, setting forth the proposed remedies in respect of the Private Party Defaults triggering the step-in, details of the person(s) nominated by the Lenders to undertake the remediation (the "**Appointed Representative**"), and a detailed timeline specifying all phases up to the completion of the remediation;

73.3.1.6 during the step-in period the Lenders (and their Appointed Representative) incur no liability;[492]

73.3.1.7 if the Private Party Default which triggered the step-in is remedied in accordance with the remedial programme and within the timeline set forth in it, then the Lenders have the option to step-out (and the Private Party must resume full performance of the Project Deliverables), or to substitute the Private Party with another entity (a "**Substitute Private Party**");

73.3.1.8 if the Lenders wish to assign the PPP Agreement to a Substitute Private Party, then the selection of the Substitute Private Party must be made by the Lenders with the prior written approval (not to be unreasonably withheld) of the Institution applying the same qualification criteria that were applied by the Institution in awarding the bid to the Private Party;

73.3.1.9 until the PPP Agreement is assigned to the Substitute Private Party, the original Private Party must remain liable under the PPP Agreement; and

73.3.1.10 if the Private Party Default triggering the step-in is not remedied in accordance with the agreed remedial programme and timeline, or any new Private Party Default occurs during the step-in period, then the Institution must be entitled to terminate the PPP Agreement in accordance with the Retendering Procedure or No Retendering Procedure (see Part N:65 (*Termination: Compensation on Termination for Private Party Default*)). However, the Institution should not have the option to retender if the No Liquid Market Test (see Clause 4 of the Standard Direct Agreement) is satisfied, that is, less than three bidders have pre-qualified.

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492 The outstanding liabilities referred to in Section 73.3.1.3 must be discharged before step-in.

73.3.2 The advantages of this approach for the Lenders are that they are informed of the outstanding liabilities of the Private Party which they are required to assume *before* exercising their election to step-in, they can step-out at any time and they incur no liabilities as a result of stepping-out.

73.3.3 In turn, the Institution retains the right to terminate if any new Private Party Default occurs or if the remedies are not being carried out in accordance with the agreed remedial programme. Thus the Private Party remains liable and any further losses (including rectification costs) incurred by the Institution during the step-in period or as a result of the Lenders stepping-out will be reflected in the compensation (whether pursuant to the Retendering Procedure or the No Retendering Procedure) payable on Private Party Default.[493]

73.4 **Accrual of Penalty Deductions**

73.4.1 As previously indicated, the step-in by the Lenders should not interrupt the ordinary running of the PPP Agreement, including the accrual of Penalty Deductions, save for the purpose of triggering termination. Stated differently, the accrual of Penalty Deductions should be suspended over the step-in period in relation to the Institution's rights to terminate the PPP Agreement, but not in relation to the Institution's rights to make Penalty Deductions against the Unitary Payment.

73.4.2 The reason for this is that the Institution should not pay for Services that are not available. Since the Penalty Deductions should reflect the loss to the Institution caused by the Private Party Default which triggered the step-in, the Institution should be adequately protected and, therefore, should not be entitled to terminate the PPP Agreement – provided, however, that the Lenders are using reasonable endeavours to ensure that the remedial programme is being implemented in the step-in period.

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[493] In this regard see Part N: (*Termination*).

73.4.3 If the Lenders step-out, the suspension of the accrual of Penalty Deductions for termination purposes should be lifted. If the step-in period ends because the Private Party has been substituted, then all accrued Penalty Deductions should be cancelled as against the Substitute Private Party for all purposes (not limited to termination), otherwise the Substitute Private Party will not be incentivised to take over the PPP Agreement.

73.4.4 The Direct Agreement used here does not grant the Institution a right to recover against the Lenders damages caused in connection with the exercise by them of their step-in rights. This is because the PPP Agreement should provide for such damages to be claimed, where the PPP Agreement is not terminated, by the Institution directly from the Private Party or, where the PPP Agreement is terminated, to be captured in the calculation of the termination compensation.

73.4.5 If the step-in occurs prior to the Service Commencement Date and during the construction or development phase of the Project, the Institution should recover its losses for non-delivery of the relevant Works from the security held by it in respect of the construction or development works. In this regard, see Part E:21 (*Duration and Service Commencement: Security Against Late Service Commencement*).

73.5 **Refinancing**

It is possible that the Project may need to be "rescued" through a Refinancing, for instance, by way of additional capital such as an increased Debt commitment in the step-in period (or thereafter if the Private Party has been substituted). Any such "rescue" Refinancing must be subject to prior written approval of the Institution.[494]

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[494] See Part Q: (*Refinancing*).

74 STANDARD DIRECT AGREEMENT[495]

*THIS DIRECT AGREEMENT[496] (this "**Direct Agreement**") IS MADE ON [date] AT, [place],*

AMONG

*(1) [RELEVANT INSTITUTION] (the "**Institution**");*

*(2) [x] (the "**Agent**" for the Lenders); and*

*(3) [x] (the "**Private Party**").*

IT IS AGREED AS FOLLOWS:

1 DEFINITIONS AND INTERPRETATION

(a) Definitions

In this Direct Agreement, unless the context otherwise requires:

*"**Affiliate**" has the meaning in the PPP Agreement;*

*"**Agent**" means the agent appointed by the Lenders and notified in writing to the Institution;*

*"**Appointed Representative**" has the meaning in Clause 5(a);*

*["**Credit Agreement**" means the [contract description], dated [x], among the Private Party, the Agent and the Lenders;][497]*

*"**Debt**" has the meaning in the PPP Agreement;*

*"**Enforcement Event**" means any acceleration of the Debt (following an event of default under the Credit Agreement) and/or the commencement of any enforcement procedure under the Security Documents, as notified by the Agent to the Institution, which notice shall describe the event of default in respect of which such acceleration and/or enforcement is carried out;*

*"**No Liquid Market**" means that less than 3 (three) parties meeting the criteria in (a), (b) and (c) of the definition of "Substitute Private Party" have pre-qualified pursuant to a request in Clause 4(a)(i);*

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[495] This Direct Agreement covers the step-in and substitution regime. Other issues may need to be dealt with, for example, the sharing of security between the Lenders and the Institution, the administration of payments from the Joint Insurance Account, the economic test for reinstatement following an insured event under the material damage policies and so forth.

[496] The Institution's prescribed form of Direct Agreement should be submitted to the relevant Treasury (along with the prescribed form of PPP Agreement and other procurement documentation) when TA:IIA is applied for. The final Agreed Form of the Direct Agreement should be settled when the PPP Agreement is settled and should be submitted to the relevant Treasury when TA:III is applied for.

If an Institution is approached after its receipt of TA:III by the Private Party or the Lenders to consider any amendments to the Direct Agreement (or Agreed Form thereof), then the Institution should first seek approval from the relevant Treasury for such amendments. That approval will only be granted by the relevant Treasury if the amendments will not have a materially adverse impact on the value for money, affordability and risk transfer requirements of the Project.

[497] This should be the loan facility, credit or common terms agreement(s) included in the Financing Agreements as defined in the PPP Agreement.

*"**Notice of Existing Liabilities**" has the meaning in Clause 3(b);*

*"**Penalty Deductions**" has the meaning in the PPP Agreement;*

*"**PPP Agreement**" means the public private partnership agreement, dated [x], between the Institution and the Private Party;*

*"**Pre-termination Notice**" has the meaning in Clause 3(a);*

*"**Private Party Default**" means any Private Party Default (as defined in the PPP Agreement) that is capable of being remedied, being any Private Party Default referred to in Clause [x] (Institution's Options) of the PPP Agreement;*[498]

*"**Project Deliverables**" has the meaning in the PPP Agreement;*

*"**Required Period**" means*[499] *the period starting on the date of a Pre-termination Notice and: (a) during the period preceding the Service Period, ending [120 (one hundred and twenty)] days later; and (b) during the Service Period, ending [90 (ninety)] days later;*

*"**Service Period**" has the meaning in the PPP Agreement;*

*"**Security Documents**" means the documents creating or evidencing the security granted by the Private Party to the Lenders (or any security company, trust or other entity appointed by them to hold the security) in respect of the Debt;*

*"**Step-in Date**" means the date on which the Agent first takes any action under Clause 5(a);*

*"**Step-in Period**" means the period from the Step-in Date up to and including the earlier of: (a) the Step-Out Date; [(b) the date of any assignment under Clause 8 (Assignment of PPP Agreement to the Substitute Private Party);] (c) the date of any termination for breach under Clause 6(b); (d) the date of expiry of the PPP Agreement; and (e) the later of the date falling [one] year after [construction completion] and the date falling [two] years after the Step-in Date;*[500]

*"**Step-out Date**" means the date falling [30 (thirty)]*[501]*days after the date of the notice given under Clause 7 (Step-out); and*

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498 This is a reference to sub-Clause (b) (ii) of the Standard Clause (*Institution's Options*) in Part N:60.3.3 (*Termination: Termination for Private Party Default*).

499 The time periods will be subject to the specific requirements of particular projects, but those suggested in this draft Clause are likely to be appropriate for many projects that have a split between the construction phase and the operating phase.

500 Clause (e) assumes that an indefinite period for step-in is undesirable. The Institution should, however, not be opposed to an indefinite period if step-in does not affect the Project (that is, performance of the Project Deliverables) unduly and if a longer period is appropriate in certain projects. The Parties should be wary of requiring the Lenders to assign the PPP Agreement to a Substitute Private Party simply to end the Step-in Period.

501 This will depend on the time required by the Institution to put in place alternative measures to provide the Service.

*"**Substitute Private Party**" means a person approved by the Institution as:*[502] *(a) having the appropriate technical and financial ability to perform the rights and obligations of the Private Party under the PPP Agreement; (b) employing persons having the appropriate qualifications, experience and technical competence; and (c) having sufficient resources available to it (including committed financial resources and subcontracts) to perform the obligations of the Private Party under the PPP Agreement.*[503]

(b) <u>Interpretation</u>

[Relevant parts of Part A:2 (Preliminary: Interpretation) of the PPP Agreement should be included here with suitable amendments where necessary].

2 CONSENT TO SECURITY

(a) The Institution acknowledges notice of, and consents to, the security interests granted over the Private Party's rights under the PPP Agreement effected by the Private Party in favour of the Lenders under the Security Documents.[504]

(b) The Institution confirms that it has not received notice of any other security interest granted over the Private Party's rights under the PPP Agreement.[505]

3 NOTICES OF PRE-TERMINATION AND EXISTING LIABILITIES

The Institution shall not terminate the PPP Agreement without giving to the Agent:

*(a) at least the Required Period of prior written notice of the proposed termination (the "**Pre-termination Notice**") stating:*

(i) the proposed termination date; and

(ii) the Private Party Default(s) constituting the grounds for termination in reasonable detail; and

*(b) not later than (A) the date falling [x] days after the date of a Pre-termination Notice or, if earlier, (B) the date falling [x] days after the date on which the Agent notifies the Institution that an Enforcement Event has occurred, a notice (the "**Notice of Existing***

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502 The criteria should at least match the criteria in the RFP for selecting the original Private Party.

503 The assignment of the PPP Agreement to a Substitute Private Party should not be necessary if the Project is remedied during the Step-in Period.

504 The Institution's consent is required by the Lenders (or any security company, trust or other entity established by them to hold the security for the Project) to enforce the security interests in and to the Private Party rights under the PPP Agreement.

505 Institutions should undertake such due diligence as is necessary to be able to make this confirmation.

***Liabilities**") containing details of any amounts owing by the Private Party to the Institution under the PPP Agreement:*[506]

(i) which are overdue at the date of the Pre-termination Notice or the date of the Agent's notice, as the case may be; and

(ii) which will fall due at any time in the period from that date to the end of the Required Period.

4 NO LIQUID MARKET

*(a) At any time in the Required Period (and not thereafter) and provided the Lenders have stepped-in, the Agent may issue written notice to the Institution (the "**No Liquid Market Notice**"):*

(i) confirming that the Lenders have issued a request for pre-qualification for the provision of the Project Deliverables for the unexpired portion of the Project Term and that there is No Liquid Market; and

(ii) describing in detail the pre-qualification process undertaken by the Lenders.

*(b) On or before the [10th (tenth)] day (excluding any Saturday, Sunday or public holiday in South Africa ("**Business Day**")) following the Institution's receipt of the No Liquid Market Notice, the Institution shall issue written notice to the Agent stating whether or not it agrees with the Agent that No Liquid Market exists, and if it disagrees with the Agent, its reasons for such disagreement.*

(c) If the Institution fails to issue a notice as required in Clause 4(b) or the Parties do not agree that No Liquid Market exists, then the Agent must refer the dispute (which shall be deemed to exist if the Institution fails to issue the required notice), for determination in terms of Clause [x] (Fast-track Dispute Resolution) of the PPP Agreement which shall apply to such dispute, mutatis mutandis.

(d) If the parties agree that No Liquid Market exists or it is so determined as aforesaid, then the PPP Agreement shall terminate automatically on the date of such agreement or determination and the provisions of Clause [x] (No Retendering Procedure) of the PPP Agreement shall apply.[507]

(e) If the No Liquid Market Notice is issued in the Required Period and a dispute is referred for determination as contemplated in Clause 4(c), then the Required Period shall be extended by the period over which

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[506] In any Project financed with limited-recourse debt, the Lenders will generally take a very active role in monitoring most aspects of the Project. They will have their own technical advisors to monitor the Private Party's and Subcontractors' performances. They will apply the financial ratios (usually, an annual historical and forecast debt service cover ratio, and a loan life cover ratio) applicable to the Project, usually at six-monthly intervals, to assess whether the cash flow of the Project will meet required debt service. The Lenders will, therefore, be better informed regarding the financial condition of the Project and the Private Party. In such circumstances there is no need for the Institution to conduct an extensive due diligence to establish the unperformed obligations of the Private Party.

[507] This determines the amount of compensation payable on termination for Private Party Default if there is no liquid market, that is, the Adjusted Estimated Project Value. See Part N:65 (*Termination: Compensation on Termination for Private Party Default*).

the dispute is determined.

5 *APPOINTED REPRESENTATIVE*

(a) *Without prejudice to the Agent's rights under the Security Documents, at any time:*

(i) *during which an Enforcement Event is subsisting (whether or not a Pre-termination Notice has been served); or*

(ii) *during the Required Period,*[508]

*the Agent may, on written notice to the Institution of no less than [5 (five)] Business Days appoint a representative (the "**Appointed Representative**") who shall jointly and severally assume all the Private Party's rights to perform all of the Project Deliverables.*[509]

(b) *Such appointment shall take effect on the next Business Day following the expiry of the notice period.*

(c) *Within [10 (ten)] Business Days after the appointment becomes effective, the Agent shall provide the Institution with full details of the remedial programme to be implemented by the Appointed Representative in respect of the Private Party Default(s) mentioned in the Pre-termination Notice (if any).*

6 *STEP-IN PERIOD*

(a) *Without limiting Clause 3 (Notices of Pre-termination and Existing Liabilities), but subject to Clause 6(b), the Institution shall not terminate the PPP Agreement during the Step-in Period on grounds:*

(i) *that the Agent has taken any action referred to in Clause 5 (Appointed Representative) or enforced any Security Document(s); or*

(ii) *arising prior to the Step-in Date of which the Institution is aware*[510] *as at the Step-in Date; or*

(iii) *arising solely in relation to the Private Party,*[511]

unless, in the case of section (ii) above:

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[508] The Institution should ensure that it has reserved in the PPP Agreement the right to enter on the property and restore problems that need urgent attention during this period.

[509] The Appointed Representative does not assume the Private Party's obligations under the PPP Agreement since the Private Party's continued liability (particularly for ongoing Services) under the PPP Agreement must be preserved as if the PPP Agreement were being performed by the Private Party.

[510] This means that, notwithstanding the discovery after the Step-in Date of a latent defect (in the Facilities constructed or developed by or on behalf of the Private Party) that actually existed prior to the Step-in Date, it should be treated as having arisen after that date. This should not apply to latent defects in the Institution Assets.

[511] For example, insolvency of the Private Party.

(aa) *[the grounds arose during the period preceding the Service Period,*[512] *and Service Commencement does not begin on or before the date falling [x]*[513] *months after the Long Stop Date (as defined in the PPP Agreement); or]*

(bb) *[the grounds arose during the Service Period, and] neither the Appointed Representative nor the Private Party is using all reasonable endeavours (including implementation of the remedial programme) to remedy the Private Party Default and that Private Party Default is continuing.*

(b) *The Institution shall be entitled to terminate the PPP Agreement by written notice to the Private Party (copied to the Agent and the Appointed Representative):*

(i) *if any amount referred to in Clause 3(b)(i) has not been paid to the Institution on or before the Step-in Date;*

(ii) *if any amount referred to in Clause 3(b)(ii) has not been paid within [x] Business Days of the due date under the PPP Agreement for that amount;*

(iii) *if any amount incurred prior to the date of the pre-termination Notice (of which the Institution was not aware (having made reasonable enquiry) at the time), and that is subsequently notified by the Institution to the Agent is not discharged on or before the date falling [30 (thirty)] days after the date of such notice;*

(iv) *if any of the provisions of (aa) or (bb) of Clause 6(a) apply; or*

(v) *for any Private Party Default arising after the Step-in Date; provided that any Penalty Deductions that accrued prior to the Step-in Date shall not be taken into account for the purposes of termination, but shall be taken into account for such purposes after the Step-out Date,*

in accordance with the terms of the PPP Agreement.[514]

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512 This refers to the construction or development phase. It may not always be clear when this phase ends, particularly in a phased construction or development. The key determinant will, of course, be the extent to which failure to complete any construction or development Works will lead to termination (thereby preventing full Service Commencement), in which case Clause (aa) will apply. If the failure is in the delivery of the Services from a completed Facility, then Clause (bb) will apply.

513 Time periods will depend on a number of issues, including the nature of the Project and the length of the construction or development phase. If there is no critical need for the Project to commence by a certain date (that is, no Long Stop Date) or the Parties believe the financial incentives are sufficiently strong, then Clause (bb) may also apply to terminations in the construction or development phase. In such event, Clause (aa) and the reference in Clause (bb) to when the grounds arose should both be deleted.

514 That is, the PPP Agreement without reference to this Direct Agreement and means grounds unrelated to the cause of the Pre-termination Notice for which a remedial programme will have been agreed. This approach is flexible enough so that termination is not inevitable. It allows the Lenders to devote time and resources to remedy the default for which the Pre-termination Notice was given without the threat of a hair-trigger termination. Here Penalty Deductions are not automatically reset to zero although, for the purposes *only* of termination, they cease accruing. Issues here are likely to be project-specific as they require parties to reach a commercial view on the likelihood of further Penalty Deductions being incurred when the Project is already in default as against potential operational issues (that is, it will depend on the Lenders' perceptions of the possibility of default and the acceptability to the Institution of a period during which it has no right to terminate).

(c) *Save as provided in Clause 6(b), the Institution shall deal with the Appointed Representative and not the Private Party during the Step-in Period. The Private Party shall be jointly and severally liable for all actions or omissions of the Appointed Representative, as if these actions and omissions are those of the Private Party.*

7. *STEP-OUT*

(a) *The appointment of the Appointed Representative shall cease on the expiry of a period of [30 (thirty)] days following the issue by the Agent of a written notice to the Institution to this effect and any rights of the Appointed Representative against the Institution will be cancelled.*

(b) *The Private Party shall continue to be bound by the terms of the PPP Agreement, notwithstanding the occurrence of the Step-out Date. The Institution shall be entitled to terminate the PPP Agreement after the Step-out Date in accordance with the PPP Agreement.*

8 *ASSIGNMENT OF PPP AGREEMENT TO SUBSTITUTE PRIVATE PARTY*

(a) *Subject to Clause 8(b), at any time:*

(i) *during which an Enforcement Event is subsisting; or*

(ii) *during the Step-in Period,*

the Agent may notify the Institution and the Appointed Representative (if any) of its desire to assign the PPP Agreement to any person and, if so, shall provide the Institution with all information regarding that person that the Institution may reasonably require to determine whether that person meets the criteria described in the definition of "Substitute Private Party".

(b) *The Institution shall notify the Agent as to whether such person is approved by the Institution as a Substitute Private Party by no later than [x] days after the Institution has received all the information in Clause 8(a). The Institution shall be entitled to withhold its approval if there is any continuing Private Party Default and the Institution has not received a remedial programme as contemplated in Clause 5(c).*

(c) *The Agent shall be entitled to assign the PPP Agreement to any such Substitute Private Party; provided that:*

(i) *(aa) such Substitute Private Party is legally and validly constituted with the legal power and authority to become a party to, and perform the Private Party's rights and obligations under, the PPP Agreement, (bb) the percentage of beneficial shareholding in such Substitute Private Party by Black People and/or Black Enterprises is no less than the Minimum Black Equity then required to be held by Black People and/or Black Enterprises pursuant to the PPP Agreement, (cc) the directors of the Substitute Private Party have no criminal convictions, and (dd) the Substitute Private Party has no outstanding tax* *liabilities (save for any such liability which is the subject of a bona fide dispute);*[515]

(ii) *if the PPP Agreement is to be assigned prior to the Service Commencement Date, the Service Commencement Date is extended by a period to allow the Substitute Private Party to achieve Service Commencement and to entitle the Substitute Private Party to a Service Period that is equivalent to the original Service Period;*

(iii) *any accrued Penalty Deductions shall not apply as against such Substitute Private Party; and*

(iv) *any approvals (if any) that may be required from any Responsible Authority (other than the Institution) under applicable Law for the selection and appointment of such Substitute Private Party shall have been obtained.*

(d) *On any assignment to any Substitute Private Party becoming effective:*

(i) *the Private Party shall be released from any obligations arising under or in connection with the PPP Agreement from that assignment date and the Substitute Private Party shall become liable for obligations arising on or after that date;*

(ii) *any accrued Penalty Deductions shall not apply as against the Substitute Private Party;*

(iii) *any then subsisting ground for termination of the PPP Agreement by the Institution shall be deemed to have no effect and any subsisting Termination Notice shall be automatically revoked; and*

(iv) *the Institution shall at the request of the Agent enter into a direct agreement with the Agent and the Substitute Private Party on substantially the same terms as this Direct Agreement.*

9 *ASSIGNMENT OF THIS DIRECT AGREEMENT*

No party to this Direct Agreement may assign any part of its rights or obligations under this Direct Agreement, save that:

(a) *the Agent may assign its rights and obligations under this Direct Agreement to a successor Agent in accordance with the Financing Agreements without the consent of the Institution;*

(b) *any Lender may assign its rights under this Direct Agreement to any Qualifying Financial Institution (as defined in the PPP Agreement)*[516]

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[515] These pre-qualification criteria are separate from the criteria to be considered by the Institution in determining the suitability of the person nominated by the Lenders. The Lenders will have to undertake the necessary due diligence to establish whether their nominee satisfies these criteria.

[516] See Part Q:79 (*Refinancing: Exemptions*) which deals with the syndication or sell-down of the Lenders' financing commitments or Debt to Qualifying Financial Institutions.

to whom it assigns its rights as Lender under and in accordance with the terms of the Financing Agreements; and

(c) the Institution may assign its rights and obligations under this Direct Agreement to any person to whom it assigns its rights and obligations under and in accordance with the terms of the PPP Agreement.

10 MISCELLANEOUS

(a) The Institution shall, at the Private Party's expense, take whatever action the Agent may require to give effect to any assignment in Clause 8 (Assignment of PPP Agreement to a Substitute Private Party).

(b) The Institution shall not take any action to wind-up or liquidate, appoint a liquidator or judicial manager or administrator, or sanction a compromise arrangement (or similar) in relation to the Private Party.

(c) This Direct Agreement shall remain in effect until the date on which all amounts which may be or become owing by the Institution to the Private Party under Clause [x][517] of the PPP Agreement have irrevocably been paid in full, whereupon the Agent shall procure the release of any and all security granted in favour of the Lenders (or any security company, trust or other entity established to hold such security) over the Project Assets so that the Project Assets shall be unencumbered. The Private Party agrees that the Institution may pay any amounts that may be due under such Clause [x] to the Agent on behalf of the Lenders and such payment shall constitute a discharge of the Institution's liability to the Private Party in respect of such amounts.[518] If the amounts so paid to the Lenders exceed the Debt, the Agent shall procure that any such excess is paid to the Private Party.

(d) The Agent shall notify the Institution of:

(i) any decisions to accelerate the maturity or demand repayment of any Debt; and

(ii) the date referred to in Clause 10(c) on or before the date falling [x] days after its occurrence;

(e) The Private Party joins in this Direct Agreement to acknowledge and consent to the arrangements in this Direct Agreement and agrees not knowingly to do or omit to do anything that may prevent any party from enforcing its rights under this Direct Agreement.[519]

517 This must cross-refer to the termination clauses of the PPP Agreement. See Part N: (*Termination*).

518 The Institution should seek advice at the time of the termination concerning whether a direct payment to the Lenders will create any accounting or taxation difficulties for the Institution.

519 It is also good practice for the Private Party to appoint the Institution as its attorney to sign any required assignment documentation so that, if assignment occurs, it does so as smoothly as possible.

(f) *For the avoidance of doubt, if there is any conflict or inconsistency between the provisions of this Direct Agreement and the PPP Agreement, the provisions of the PPP Agreement prevail.*

(g) *The Agent agrees on behalf of itself and the Lenders that [include relevant "boiler plate Clauses" from the PPP Agreement.[520]]*

11 *GOVERNING LAW AND JURISDICTION*

This Direct Agreement is governed by the laws, and subject to the exclusive jurisdiction of the High Court, of the Republic of South Africa.

520 These provisions should be consistent with the provisions of the PPP Agreement and impose an equivalent but separate liability on the Lenders to that to which the Private Party is subject.

PART P: INFORMATION AND AUDIT ACCESS

75 INFORMATION AND AUDIT ACCESS

75.1 Pursuant to Treasury Regulation 16.7, the accounting officer or accounting authority of an Institution is responsible for reporting on the management of a PPP Agreement in the annual report of the Institution. The scope of that reporting obligation is regulated by the PFMA and the Auditor-General Act, 1995.[521]

75.2 The Private Party should be under an ongoing obligation to disclose to the Institution all information in connection with the PPP Agreement which the Institution may reasonably require in order to give effect to its financial reporting obligations under the legislation mentioned above, as well as its disclosure obligations under other applicable legislation, such as the Promotion of Access to Information Act, 2000, and legislation governing health and safety and the environment.

75.3 It should be noted that pursuant to the Auditor-General Act, 1995, the Auditor-General has a discretion:

75.3.1 to determine the nature and extent of any audit carried out by it;

75.3.2 to investigate whether any property or any other assets of an Institution, including any Institution Assets, are being applied efficiently and effectively;

75.3.3 to investigate any matter relating to expenditure on the part of the Institution being audited by the Auditor-General, including any expenditure in relation to Unitary Payments; and

75.3.4 to publish details of the utilisation of the assets or resources of an Institution and its expenditure which the Auditor-General determines is uneconomical, inefficient, ineffective or detrimental. This discretion

[521] See also Module 7: Auditing PPPs.

would include an ability to comment on and publish any such issues which arise in relation to performance of a PPP Agreement.

75.4 The Institution should ensure that the PPP Agreement contains adequate provisions allowing the Institution to gain access to such information concerning the Project as is reasonably necessary to meet its audit and disclosure obligations.

Standard Clause

<u>Information and Audit Access</u>[522]

(a) *The Private Party shall provide to the Institution all information, documents, records and the like in the possession of, or available to, the Private Party as may reasonably be requested by the Institution for the purpose of complying with any of its statutory reporting obligations including its reporting obligations under the Public Finance Management Act, 1999 and the Auditor-General Act, 1995.*[523]

(b) *To this end the Private Party shall use all reasonable endeavours to ensure that all such information in the possession of any counter-party to any Project Document shall be available to the Institution and the Private Party has included, or shall include, appropriate provisions to this effect in all Project Documents.*

(c) *Without limiting the generality of the aforegoing, the Private Party shall:*

(i) *provide and shall procure that its Subcontractors shall provide all such information as the Institution may reasonably require from time to time to enable the Institution to provide reports and returns as required by any Responsible Authority, including reports and returns regarding the physical condition of any building occupied by the Institution, health and safety, national security, and environmental safety; and*

(ii) *note and facilitate the Institution's compliance with the Promotion of Access to Information Act, 2000 in the event that the Institution is required to provide information to any person pursuant to that Act.*

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[522] In this Standard Clause, the scope of the reporting obligation of the Private Party extends not only to financial information but also to any other information that an Institution would be obliged to disclose.

[523] The Private Party and its funders may request a carve-out from this reporting obligation in respect of any financial information relating to the PPP Agreement that extends to the financial arrangements in the Financing Agreements and Shareholders Agreement. This should be considered in light of the aforementioned statutory obligations.

PART Q: REFINANCING

76 INTRODUCTION

76.1 For the purpose of this Standardisation "**Refinancing**" includes any change in the nature of or the terms governing the funding structure of a Project (that is, in respect of Debt, Equity and/or Shareholder Loans) as it was approved by the Institution at the Signature Date.[524]

76.2 Refinancings which effect, among other things:[525]

76.2.1 a reduction in interest margins applicable to the Debt;

76.2.2 a reduction or release of the cash balances in any reserve accounts or the cancellation or termination (partially or in full) of letters of credit;

76.2.3 a release of contingent liabilities owed by the Shareholders or their Affiliates in respect of their financial obligations to the Private Party and/or the Lenders (or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders);

76.2.4 an extension in the maturity of the Debt;

76.2.5 a rescheduling of the repayment of principal or the payment of interest included in the Debt; or

76.2.6 an increase in the amount of Debt,

may each have the effect of increasing or accelerating the dividends or other distributions deriving from the Project for the benefit of the Shareholders, or of reducing their funding commitments in respect of the Project. This upside (collectively, referred to as a "**Refinancing Gain**") should be shared between the Institution and the Private Party.

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[524] It should be noted that a Refinancing may also be undertaken without the direct involvement of the Private Party, for example, through a special-purpose holding company which relies on rights granted in respect of the cash flows of the Project and other Project Assets of the Private Party (including its rights under its contracts).

[525] This is not a closed list.

Standard Definitions

*"**Base Case Equity IRR**" means, having regard to the base case Financial Model,*[526] *the nominal post-tax Equity IRR as at the Signature Date, being [x]%;*

*"**Distributions**" means,*

(a) whether in cash or in kind, any:

(i) dividend or distribution of share capital;

(ii) reduction of share capital, stated capital, any capital redemption fund or any share premium account;

(iii) cancellation, conversion, redemption or re-purchase of shares or any other variation whatsoever in share capital;

(iv) payment in respect of the Shareholder Loans (whether of principal, interest, breakage costs or otherwise); or

(v) payment, loan or other financial assistance, transfer of rights or other assets or receipt of any other benefit to the extent put in place after the Signature Date and not in the ordinary course of business, not on an arm's length basis or not otherwise on reasonable commercial terms; or

(b) release of any contingent liability of any of the Shareholders or their Affiliates in respect of their financial obligations to the Private Party and/or the Lenders (or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders). Such release shall be deemed to be a cash amount for the purpose of calculating the Refinancing Gain;

*"**Equity IRR**" means the projected blended*[527] *rate of return to the Shareholders and their Affiliates over the full Project Term, having regard to Distributions made and forecast to be made;*

*"**Net Present Value**" or "**NPV**" means the aggregate of the discounted values, calculated as at the estimated date of the Refinancing, of each of the relevant projected Distributions, in each case discounted using the Base Case Equity IRR;*

*"**Permitted Borrowing**" means, at any time after the Signature Date, any advance made to the Private Party under the Financing Agreements for the purpose(s) specified therein;*[528]

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[526] This is the base case equity IRR in the Financial Model as at the Signature Date.

[527] That is, including both the Equity and the Shareholder Loans.

[528] If the facilities committed by the Lenders at the Signature Date (or, where the Financing Agreements are executed after the Signature Date, on the terms included in the Agreed Form thereof) include a standby facility for the purpose of funding any unforeseen cost overruns, increased expenses or losses of revenue incurred by the Private Party, then the reference to "advance" in this definition must specify this purpose in relation to such standby facility so that the facility will not be applied to prepay amounts owed to the Shareholders under the Shareholder Loans, thereby providing an escape route for avoiding Refinancing Gains.

*"**Refinancing**" means, at any time after the Signature Date:*

(a) any amendment, assignment, novation, replacement or supplementing of any of the Financing Agreements (or the Agreed Form thereof, if any such agreement has not been executed by the Signature Date), whether independently or in combination with any connected arrangements;

(b) the exercise of any right or grant of any waiver, indulgence or approval under any of the Financing Agreements (other than a Permitted Borrowing);

(c) the disposition or encumbering (by whatever means) of any rights under any of the Financing Agreements or the creation or granting of any other benefit or interest in any of the Financing Agreements or any of the Private Party's other contracts, Project revenues or Project Assets; or[529]

(d) any other arrangements having any of the effects in Clauses (a) to (c) (inclusive);

*"**Refinancing Gain**" means in relation to any Refinancing (other than an Exempt Refinancing), an amount equal to the greater of nil and [(A - B) - C], where:*

A = the Net Present Value of the Distributions forecast immediately prior to such Refinancing (having regard to the Financial Model, as updated to that time), taking into account the effect of the Refinancing, including the costs of the Refinancing, to be made over the remaining Project Term;

B = the Net Present Value of the Distributions forecast immediately prior to such Refinancing (having regard to the Financial Model, as updated to that time), not taking into account the effect of the Refinancing or the costs of the Refinancing, to be made over the remaining Project Term; and

C = any adjustment required to raise the nominal post-tax Equity IRR calculated immediately prior to such Refinancing (having regard to the Financial Model, as updated to reflect all changes in the operating assumptions for the Project, and taking into account the actual performance of the Project to that time)[530] *to the Base Case Equity IRR.*

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[529] This is intended to capture any payments or the like to Affiliates of the Private Party and each of its Shareholders that are "dressed up" as ordinary payments for operational or capital expenditure (but are really profits) in order to avoid the sharing of Refinancing Gains.

[530] See Section 80.2.1 (*Calculation*).

77 KEY PRINCIPLES

77.1 The key principles underlying the prescribed approach to Refinancing are as follows:

77.1.1 Refinancings may be of benefit to both the Private Party and the Institution;

77.1.2 a Refinancing may constitute a material change to the funding structure of a PPP as agreed between the Parties at the Signature Date. Therefore, an Institution should generally have the right under the PPP Agreement to be fully informed of any proposed Refinancing and must notify the relevant Treasury in advance thereof save in the case of a Refinancing as described in (d) of the definition of Exempt Refinancing,[531] for which no advance notification is required. Further the Institution must have the right to pre-approve any proposed Refinancing, other than Exempt Refinancings. The exercise of this pre-approval right by the Institution is subject to any Treasury Approvals required pursuant to Treasury Regulation 16 in relation to amendments to the PPP Agreement;

77.1.3 although increases in the returns to investors in the Private Party due to improved performance (over and above those anticipated at Financial Close) should generally be for their benefit, where increased returns derive from changes in the nature of or the terms governing the funding structure of the Project they should be shared between the Institution and investors;

77.1.4 as the PPP market in South Africa matures and stabilises, better funding terms should become available. In the broadest sense, both the public sector and the private sector will contribute in bringing about this improvement. Therefore, both sectors should share in the improved terms available for Refinancings; and

[531] See Section 79 (*Exemptions*).

77.1.5 a 50:50 sharing of the Refinancing Gains between the Institution and the Private Party provides a fair balance.

77.2 The complexity of Refinancings means that it is important that Institutions seek appropriate financial and legal advice when considering the subject to ensure that the prescribed approach in this Standardisation is properly reflected in the PPP Agreement, the Project Documents and any negotiations with the private sector on proposed Refinancings.

78 INSTITUTION APPROVAL

78.1 **For Certain Refinancings**

78.1.1 An Institution should generally have the right to pre-approve any proposed Refinancing, save for "Exempt Refinancings" (as defined in Section 79 (*Exemptions*)).

78.1.2 When evaluating a proposed Refinancing, an Institution should carefully consider whether the effects of such proposal might:

78.1.2.1 increase the risks borne by the Institution;

78.1.2.2 impact on the Private Party's ability or capacity to manage and mitigate the risks allocated to the Private Party under the PPP Agreement;

78.1.2.3 reduce incentives for the Private Party to achieve sustained service standards over the remainder of the Project Term; or

78.1.2.4 undermine the financial stability of the Private Party, thereby endangering the provision of the Project Deliverables.

78.1.3 When considering a request for approval of a proposed Refinancing, the Institution should objectively assess the Private Party's proposals. There may be occasions where, for good reasons, the Institution refuses to approve a Refinancing despite the opportunity to share any resultant Refinancing Gains. A refusal to approve a Refinancing may be appropriate, for example, where the Private Party proposes a new funding structure, which the Institution perceives to be far less flexible than the structure it replaces in projects where the Institution places a high value on flexibility. However, an Institution should not use its right to pre-approve any increases in its termination liabilities to agree to a greater than 50% share of any Refinancing Gain.

78.1.4 Generally, Refinancings that increase the risks borne by the Institution (for instance, by replacing Equity and/or Shareholder Loans with new Debt) will also result in greater gains for sharing. Any material change in the risk profile of a Project must be pre-approved by the relevant Treasury pursuant to Treasury Regulation 16.8. The relevant Treasury is unlikely to withhold its approval if the Institution's 50% share of the Refinancing Gains is reasonable compensation for the increased risks it is being asked to bear as a result of the new funding structure; provided that the required value for money and affordability are sustained.

78.2 For Increases in Termination Liabilities

The PPP Agreement should provide that if a proposed Refinancing involves an increase in the liability of an Institution upon termination of the PPP Agreement (for instance, increases in the Debt, the Shareholder Loans or the Equity beyond that agreed at the Signature Date), then the Institution's approval would be required for such increase in the Institution's termination liabilities as a *separate and distinct* approval from the approval (if any) required for the Refinancing. The Institution's capacity to agree to a change in its termination liabilities is also subject to the requirement for the Treasury approval in Treasury Regulation 16.8. That approval will hinge on, among other things, any affordability constraints.

79 EXEMPTIONS

The following Refinancings should be subject to prior notification to the Institution but not be subject to either prior approval by the Institution (save as provided in Section 78.2 (*For Increases in Termination Liabilities*)) or any sharing of the Refinancing Gains:

79.1 **Shareholder Capital**

79.1.1 Any disposals of investments or commitments of capital in the Private Party that are Equity or Shareholder Loans should be exempt from the Refinancing approval and sharing restrictions. This exemption is subject to any prior approvals required in relation to any Changes in Control or changes in BEE shareholding (see Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*)).

79.1.2 Similarly exempt are payments of dividends in respect of the Equity and payments in respect of the Shareholder Loans (but only after all other creditors having rights in relation to the cash flows of the Project and other assets of the Private Party have been paid).[532]

79.2 **Base Case Refinancings**

79.2.1 The bidders should be encouraged in the RFP to anticipate the gains from Refinancings in their bids. Refinancings that are clearly and fully included in the base case Financial Model at the Signature Date and taken into account in the calculation of the Unitary Payment should therefore be exempt from Institution approval and gain-sharing up to the amount included in that base case.

79.2.2 To guard against the Private Party seeking to use this exemption to bypass the Refinancing Gain sharing provisions, the due diligence to be undertaken by the Institution and its advisors should extend to any Refinancing assumptions that have been taken into account in any bids. If an Institution receives a bid, which claims to take into account future Refinancings, then the Institution should specifically identify this in its application for TA:IIB.

[532] This assumes that the project finance structure (as set out in the Financing Agreements) will provide for the ordinary cash flow "waterfall" structure, which places payments to the Shareholders (and other Distributions) last in the line of payees (after payment of capital expenditure and operating costs, taxes, debt service and reserves).

79.3 Corporate Finance

79.3.1 Projects originally undertaken on a strictly corporate finance basis[533] should be exempt from any Refinancing approvals or gain-sharing. In the due diligence to be undertaken by the Institution (and its advisors) an assessment must be made of the structure and nature of a bid being put forward on a corporate finance basis to confirm that the funding structure being proposed is a true corporate finance structure and not one designed to bypass the Refinancing provisions.[534]

79.3.2 Whether or not a bid proposes a corporate finance structure should be determined on a project-by-project basis.

79.3.3 This exemption applies only to the extent that such corporate finance arrangements are implemented at the Signature Date, since the benefits to an Institution of a corporate finance approach cannot be retrospectively introduced and are fundamental to the justification of this exemption. If the Private Party subsequently seeks to introduce a project finance structure to a Project that has initially been corporate financed, the PPP Agreement (and the Financial Model) will have to be renegotiated to reflect the new funding structure and a reallocation of benefits will then become necessary so as to include provisions on Refinancing. Any new funding structure will obviously be a material change for the purposes of Treasury Regulation 16.8 and, accordingly, the Institution will have no capacity to agree to such a change without the prior approval of the relevant Treasury.

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533 As regards the basic differences between a corporate finance and project finance structure see (C) (*Other Funding Structures*) in the Preface.

534 When applying for TA:IIB in respect of the evaluation of the bids received in a PPP procurement, the Institution must clearly identify the nature of the funding structure (that is, corporate finance or project finance or other) of the preferred bidder in order to establish whether the Refinancing provisions will apply to this bidder.

79.4 **Taxation and Accounting Policies**

Changes in taxation or in the Private Party's accounting policies, such as depreciation, are not considered to be Refinancings.[535]

79.5 **Syndications**

Refinancings do not include the sell-down of financing commitments or the assignment of participations in the Debt by the original Lenders to a Qualifying Financial Institution (see the Standard Definition below).

Standard Definitions[536]

*"**Exempt Refinancing**" means any Refinancing:*

(a) that effects a sale or cession of the whole or any part of Equity or the Shareholder Loans or securitisation of the rights attaching to the Equity or the Shareholder Loans; provided that this exemption shall not limit the application of Clause [x] (Change in Control and Black Equity);[537]

(b) that was taken account of fully in the calculation of the Unitary Payment;

(c) that arises solely from a change in taxation or accounting treatment;

(d) that comprises a waiver, approval or any similar action taken in respect of breaches of warranties or representations or the late or non-provision of required information, and which occurs in the ordinary day-to-day administration of the Financing Agreements, the Shareholders Agreements or the Subcontracts; or

(e) that effects any syndication, sell-down, cession or grant of any rights of participation or security by the Lenders (or any agent acting on their behalf, or any security company or trust holding any security in respect of the Debt for the benefit of the Lenders) of or in relation to any of its rights under any of the Financing Agreements in favour of any Qualifying Financial Institution.

*"**Qualifying Financial Institution**" means a bank as defined in section 1 of the Banks Act, 1990, any pension fund or provident fund registered in terms of the Pension Funds Act, 1956, any unit trust scheme as defined in section 1 of the Unit Trusts Control Act, 1981, any long-term insurer as defined in*

[535] However, with regard to Part B:4 (*Project Documents and Project Deliverables: Project Documents*), if these changes involve any amendments to Project Documents, then the Institution's (and the relevant Treasury's) approval will be required and should be subject to the usual critical due diligence as to their likely impact on risk transfer, affordability and value for money. Institutions must inform the relevant Treasury regarding any such proposed change for which its approval is required.

[536] This definition follows the assumption that the Project will be funded substantially on a project finance basis. If the Project is funded on a strictly corporate finance basis or on a corporate finance basis with capital contributions from the Institution, then these Refinancing Clauses and definitions should not be incorporated in the PPP Agreement.

[537] See Part S:83.3 (*Miscellaneous: Changes in Shareholding and Control*).

section 1 of the Long-term Insurance Act, 1998, or any short-term insurer being a person registered or deemed (in terms of the Short-Term Insurance Act, 1998) to be registered as a short-term insurer in that statute.

80 METHOD OF CALCULATING, SHARING AND PAYING REFINANCING GAINS

80.1 The PPP Agreement will not set out the detailed basis and method of calculating the Refinancing Gains as these will vary depending on the type of Refinancing and will need to be agreed between the Parties at the time of the Refinancing.

80.2 High-level principles for calculating, sharing and paying Refinancing Gains are set out below. If an Institution wishes to deviate from these principles, it must indicate its intention in this regard to the relevant Treasury when applying for TA:IIA. If these deviations are proposed by any bidders, then these deviations must be clearly indicated in their bid documents. The relevant Treasury will consider an alternative approach if it demonstrates better value for money (for example, where there is a substantial residual value or demand risk or where there is substantial third party income).

80.2.1 Calculation

(a) The Refinancing Gain is derived from changes in the Distributions forecast to take place after the Refinancing when compared with the position immediately before the Refinancing.

(b) These changes can be negative and positive. For example, if the Private Party raises additional amounts of debt, that additional debt will probably be paid out as an immediate Distribution (for example, to prepay the subordinated Shareholder Loans), and will thus be an increase compared to the pre-Refinancing position. Thereafter, however, as the amount of the overall debt has increased, debt service payments will be greater and future Distributions lower than the pre-Refinancing position.

(c) These positive and negative changes in the Distributions should be discounted to their NPV at the date of the Refinancing. The result of this NPV calculation is the Refinancing Gain. Thus the Refinancing Gain is not necessarily an actual cash sum as at the date of the Refinancing and the payment method for the Institution's share must take this into account.

(d) The prescribed discount rate for the NPV calculation is the Base Case Equity IRR. This is because if the funders did not undertake the Refinancing, then this is the original rate of return they would be earning from the capital invested by them in the Project, so the gains to be derived from the Refinancing should be benchmarked against this rate. The funders might argue that the discount rate should be the equity IRR that an investor in the Project at the time of the Refinancing would expect to earn, because this reflects the actual risk profile and performance of the Project at the time of the Refinancing. However, there is no objective way of determining this rate in advance and leaving it to be determined at the time of the Refinancing will create opportunities for a rate to be constructed that might not be fair to all parties.

(e) To the extent that the payment of the Institution's share of the Refinancing Gain is tax-deductible, this benefit to the Private Party should be taken into account in the calculation.

80.2.2 Sharing

(a) The Institution may only take its 50% of the NPV of the gains to be derived from a Refinancing after an adjustment is made that allows for the exclusion of that portion of the gain which was originally projected to be made (that is, excluding that part of the gain which achieves the Base Case Equity IRR) and before taking the Refinancing Gain into account.

(b) Accordingly, if the Equity IRR before the Refinancing is less than the Base Case Equity IRR, then that portion of the gain deriving from the Refinancing which, if received by the Shareholders as at the Refinancing date, would increase the Equity IRR before the

Refinancing up to the Base Case IRR, should be excluded from the gain-sharing and the Institution should only share in the balance of the gains deriving from the Refinancing.

(c) Consequently, the Base Case Equity IRR is of key significance to the Institution, which during the course of its due diligence must satisfy itself as to the reasonableness of this rate. This is a critical issue if competition has been weak such that either the Base Case Equity IRR is artificially high or, conversely, the Base Case Equity IRR is artificially low given the use of overly conservative assumptions (for example, in relation to accounting policies, changes to which are exempt from the sharing of any Refinancing Gains).

(d) Although this approach is an equitable one, it will create scope for the manipulation and exaggeration of projections to show that the Base Case Equity IRR has not been passed. The Institution should, therefore, ensure that it is in a position to understand the pre-Refinancing Equity IRR and Base Case Equity IRR and to properly evaluate the past and projected performance of the Project applying the pre-Refinancing Equity IRR and Base Case Equity IRR. To do so, it will need the following information from the Private Party:

(i) the base case Financial Model with the projections that were originally used to calculate the Unitary Payment, adjusted for any changes in the Project structure and funding (for example, Institution Variations) which have taken place since the Signature Date;

(ii) details of the actual timing and amounts of the cash investments of the Equity and the Shareholder Loans from the Signature Date to date (and estimated to the Refinancing date);

(iii) information on the actual cash flow of the Private Party from the Signature Date to date (and estimated to the Refinancing date), all set out under the same headings as in the base case Financial Model;

(iv) details of the actual timing and amounts of all Distributions from the Signature Date to date (and estimated to the Refinancing date);

(v) a pre-Refinancing financial model with projections for the cash flow of the Private Party from the estimated Refinancing date to the end of the Project Term, including projected Distributions,[538] before taking the Refinancing into account;

(vi) term sheet or other relevant information on the terms of the Refinancing;

(vii) a post-Refinancing financial model with projections for the cash flow of the Private Party from the estimated Refinancing date to the end of the Project Term, including projected Distributions, after taking the Refinancing into account;

(viii) a calculation of the Refinancing Gain based on the above; and

(ix) information on the assumptions for the projections in the pre-and post-Refinancing financial models.

80.2.3 <u>Payment</u>

(a) The Institution should take its 50% share of the Refinancing Gain as a cash lump-sum and/or by a reduced Unitary Payment. In

[538] Unless there is some clear reason to the contrary, the assumption should be made that all surplus cash flow is paid out not less than six-monthly as Distributions, to avoid underestimation of the Equity IRR.

revenue-generating PPPs, the Institution should consider the option of a deferred payment arrangement if the Refinancing Gain is not an amount of cash, which becomes available immediately after the Refinancing.

(b) Although the Refinancing Gain (even a long-term Refinancing Gain such as reduced interest margin) will always be expressed in NPV terms as a fixed amount, it will not necessarily be an amount of cash which is immediately available on a Refinancing. Accordingly, in determining the appropriate form of payment, the Institution should take note of the form and timing of any Refinancing Gains obtained by the investors and should not expect to get its share of the Refinancing Gain any faster than the investors.

(c) If the Refinancing involves the raising of an amount of new Debt in prepayment of the Shareholder Loans, this will lead to a large initial Distribution followed by reduced Distributions until maturity to offset the increase in debt service. The Institution may not take 50% of the initial Distribution if this exceeds the Institution's 50% share of the total Refinancing Gain. Accordingly, the Institution may have to take less than 50% of the initial Distribution. If the percentage of the initial Distribution taken up by the Institution is less than the Institution's 50% share of the total Refinancing Gain, then the balance should be taken by way of reductions in the Unitary Payment. Thus a mixture of cash lump-sum and reduced Unitary Payment may be appropriate.

(d) If new Debt is not being raised, the gains from the Refinancing (for example, a reduction in the interest margin) generally accrue over a longer period. In these circumstances, the Institution's share of the gains should be taken as a reduction in the Unitary Payment.

(e) Where the Institution's share of Refinancing Gains is to be paid by way of a reduced Unitary Payment or, in the case of revenue-generating PPPs, any other deferred payment arrangement, the reduction in the Unitary Payment or other deferred payment arrangement should not be conditional on the future performance of the Project. Since the payment of the Institution's share of the Refinancing Gain is deferred here, the Institution should also be entitled to interest thereon. The rate of interest to be applied here should be the uniform interest rate for debts owing to the state as prescribed from time to time by the Minister of Finance pursuant to section 80 (1)(b) of the PFMA.

81 AUDIT RIGHTS, TRANSACTION COSTS AND TERMINATION

81.1 Audit Rights and Transaction Costs

81.1.1 In order to enable the Institution to determine whether or not any Refinancing is subject to its prior approval and its entitlement to any Refinancing Gains, the Institution must have the right (exercisable at any time before the Refinancing is implemented) to audit the financial model used for the Refinancing and the calculation of the Refinancing Gains, and the underlying assumptions for the data and projections used in the model, and to review documentation resulting from the Refinancing, even if the Refinancing appears to be an Exempt Refinancing.[539]

81.1.2 This audit right is also important to enable the Institution to assess the potential adverse impact (if any) of the proposed Refinancing on the Institution's termination liabilities and on the Private Party's incentive to sustain the required service standards over the remainder of the Project Term.

81.1.3 The Private Party must reimburse the Institution for its reasonable costs of engaging suitable advisors to review and advise it regarding any Refinancing or Exempt Refinancing proposals. The Refinancing Gain must be calculated after deducting any reasonable third party costs incurred by the Parties in connection with the proposed Refinancing.

[539] See also Section 80.2.2(d) above.

Standard Clause

Refinancing

(a) *The Private Party shall promptly notify the Institution in writing prior to taking any steps to implement any proposed Refinancing (including any Exempt Refinancing, save for an Exempt Refinancing as described in (d) of the definition thereof). Such notice shall include (i) full details of any proposed amendments to be made to or waivers granted under any of the Project Documents to give effect to such Refinancing, (ii) a copy of the proposed financial model relating to such Refinancing (if any) and the basis for the assumptions used in that financial model, (iii) the reasons for such Refinancing and (iv) any other information that may be reasonably necessary to enable the Institution to assess such Refinancing having regard to the following provisions.*

(b) *The Private Party shall procure that no Refinancing (other than an Exempt Refinancing) is implemented without the prior written approval of the Institution.*

(c) *Subject to Clause (a), the Private Party may implement any Exempt Refinancing without the prior approval of the Institution.*

(d) *The Institution shall be entitled to receive a 50% share of the Refinancing Gain arising from any Refinancing (other than an Exempt Refinancing).*

(e) *The Institution shall be entitled on prior written notice to the Private Party (at any time before, during and/or after any Refinancing) to audit any financial model and documentation relating to any Refinancing (including any aspect of the calculation of the Refinancing Gain).*

(f) *The Institution shall have the right to elect to receive its share of any Refinancing Gain:*

   (i) *as a single cash payment in an amount equal to the lesser of (i) 50% of any Distribution made on or about the date of the Refinancing and (ii) the Institution's 50% share of the Refinancing Gain, and the balance (if any) of its 50% share of the Refinancing Gain as a reduction in the Unitary Payment over the remaining Project Term; or*

   (ii) *as a reduction in the Unitary Payment over the remaining Project Term.*

(g) *The Institution and the Private Party will negotiate in good faith to agree the basis and method of calculation of the Refinancing Gain and payment of the Institution's share of the Refinancing Gain (taking into account how the Institution has elected to receive its share of the Refinancing Gain under Clause (f)). If the Parties fail to agree the basis and method of calculation of the Refinancing Gain or the payment of the Institution's share, then the dispute shall* *be determined in accordance with Clause [x] (Fast-track Dispute Resolution).*[540]

(h) *The Refinancing Gain shall be calculated after taking into account (i) the reasonable and proper professional costs that each Party incurs directly in relation to such Refinancing, and (ii) if the Institution's share of the Refinancing Gain is deductible in the hands of the Private Party for income tax purposes, the resulting tax benefits to the Private Party. The Private Party shall pay to the Institution all such costs incurred by the Institution within [x] days of any such Refinancing.*

(i) *For the avoidance of any doubt, the notification and approval requirements set forth in this Clause (x) (Refinancing) do not apply to any Permitted Borrowing.*

81.2 **Termination**

The Institution may terminate the PPP Agreement for any breach of the Refinancing provisions. In such circumstances, the amount of compensation payable to the Private Party shall be the same as that paid to the Private Party if the PPP Agreement is terminated for Private Party Default.

[540] Any dispute should be determined in accordance with the fast-track dispute resolution procedure provided for in the PPP Agreement. See the Standard Clause in Part S:86.2 (*Miscellaneous: Fast-track Dispute Resolution*).

PART R: INTELLECTUAL PROPERTY

82 INTELLECTUAL PROPERTY

82.1 Introduction[541]

82.1.1 In most PPPs, the Private Party will need to use some type of intellectual property in order to perform the Project Deliverables. The Private Party may use intellectual property that it has developed. However, given that the Private Party is an SPV and that the Project Deliverables will be subcontracted, it is more likely to use intellectual property developed by third parties (including the Subcontractors, their Affiliates or other parties). If the Private Party uses third party intellectual property, the Private Party will need a licence to lawfully use that intellectual property. Intellectual property licences typically contain provisions that prohibit the licencee from transferring its rights under the licences to third parties or allowing third parties to use the intellectual property.

82.1.2 Accordingly, Institutions must review all Licensed Intellectual Property made available by the Private Party to ensure that the terms of the licences permit the Institution (or its nominee)[542] to use the intellectual property:

82.1.2.1 during any Institution step-in period;[543]

82.1.2.2 following the termination of the PPP Agreement for any reason (whether this is an Institution Default, a Private Party Default, a Force Majeure event or a Corrupt Act); and

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541 In PPPs involving substantial IT components, the rights attaching to intellectual property and the scope of protections required to deal with infringements of intellectual property rights will have to be more refined than is dealt with in this Part R: given, among other things, the complexities associated with this kind of technology. Accordingly, an Institution involved in an IT project must obtain appropriate technical and legal advice in the phase preceding the issue of TA:IIA.

542 This nominee includes any New Private Party appointed by the Institution pursuant to the Retendering procedure (if applicable) following a Private Party Default. See Part N:65.4 (*Termination: Compensation on Termination for Private Party Default, Retendering Procedure*).

543 The Lenders will also be concerned that their Appointed Representative will be able to lawfully use the Licensed Intellectual Property during any Lenders' step-in under the Direct Agreement and that, should the Lenders exercise their substitution rights under the Direct Agreement, the intellectual property licences will be freely transferable to the Substitute Private Party appointed pursuant thereto.

82.1.2.3 following the expiry of the PPP Agreement, unless the Licensed Intellectual Property is not critical for the continued performance of the institutional function previously performed by the Private Party through the Services and alternative intellectual property is available at a cost that will not materially reduce the value for money of the intellectual property requirements of the Institution.

The Institution's requirements here must be specified in the RFP so that all the bidders are given the opportunity to obtain the necessary consent rights and adequately price for the cost of these rights in their bids.

82.1.3 Irrespective of who owns the Licensed Intellectual Property to be procured by the Private Party for the Project, the PPP Agreement must provide for the use rights contemplated in Section 82.1.2.[544] The use rights required during any Institution step-in period or following the termination of the PPP Agreement must not attract any royalties for the Institution. This is based on the assumption that the cost of these use rights will be included in the Unitary Payment and/or the termination compensation. Whether the use rights required after the *expiry* of the Project Term should attract any royalties will depend on:

82.1.3.1 whether the use rights are required only for the continued performance of the same institutional function performed by the Private Party through the Services or whether they are required for the performance of any other institutional functions; and

82.1.3.2 whether the Intellectual Property is specifically developed or custom-made for the institutional function performed through the Services ("**Customised Intellectual Property**").[545]

82.1.4 Where any Institution Assets to be made available to the Private Party include Intellectual Property owned by the Institution (for example, its name, logo, and so forth) or used by the Institution under licence, the

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[544] See also Part N:61 (*Termination: Effects of Termination*), particularly Standard Clause (e).

[545] See Section 82.3 (*Intellectual Property Rights on Termination and Expiry*) below.

Institution should seek legal advice (before applying for TA:IIA) regarding how the Private Party's use rights should be structured, particularly if the Institution wishes to preserve any rights in respect of this Intellectual Property.[546] In the case of intellectual property licensed to the Institution, the Institution must have regard to any licence restrictions impacting on the Institution's ability to permit the Private Party to use that intellectual property.

82.1.5 The PPP Agreement must require each Party not to infringe the rights of third parties in respect of any Licensed Intellectual Property, including any rights of the licensor arising under any licence relating to such Licensed Intellectual Property. The PPP Agreement must set out the consequences of any such infringement.

82.2 **Infringement**

82.2.1 Where the Private Party infringes the rights of third parties in respect of the Licensed Intellectual Property, the following should apply:

82.2.1.1 the general principle is that any losses resulting from infringement by the Private Party of such rights should be borne by the Private Party. It should be responsible for any losses of the owner of those rights and any direct losses of the Institution. The Private Party indemnities (see the prescribed approach in Part C:9 (*General Obligations: Indemnities and Claims for Damages*) and Part C:10 (*General Obligations: Double Recovery and Mitigation*) should extend to third party claims against the Institution arising from the infringement of those rights; and

82.2.1.2 if the infringement or related legal action threatens the performance of the Project Deliverables, the Institution should be notified as soon as possible. The Institution should be obliged to provide reasonable assistance to the Private Party in defending any legal action to the extent necessary to preserve the continued

[546] See the Standard Clause in Section 82.4 (*Intellectual Property of the Institution*).

performance of Project Deliverables, but this should not extend to meeting any costs of the Private Party's defence.

82.2.2 If the Institution infringes the rights of any third parties in respect of the Licensed Intellectual Property, it should bear the costs of any resulting third party claims, save to the extent that such infringement results from the Private Party's conduct. Since these costs may include the consequential losses of the owner of the intellectual property and any costs incurred by the Private Party (for instance, if it is sued by the owner and it needs to obtain a licence for replacement intellectual property rights from another person) the exposure of the Institution might be great. Accordingly, it is critical that the Institution conducts a thorough due diligence on all Licensed Intellectual Property procured by the Private Party for the Project. The Institution should also ensure that the PPP Agreement incorporates appropriate undertakings from the Private Party regarding the use of the Licensed Intellectual Property by the Institution (or its nominee). These use rights should generally permit the Institution (or its nominee) to use the Licensed Intellectual Property in the continued provision of the Project Deliverables during any Institution step-in and, where the PPP Agreement is terminated or expires (save as provided in Section 82.1.2.3), in the continued delivery of the same institutional function previously performed by the Private Party; subject in either case to any reasonable limitations on the abuse of such use rights. Any indemnities granted by the Institution regarding such abuse should be consistent with the approach prescribed in Part C:9 (*General Obligations: Indemnities and Claims for Damages*) and Part C:10 (*General Obligations: Double Recovery and Mitigation*).

82.2.3 Where the Institution may itself contribute any Licensed Intellectual Property to the Project for the Private Party to use in the performance of the Project Deliverables, it must ensure that it has the rights to do so (see Section 82.1.4). In addition, the Institution should make available to all the bidders the terms of the licences held by it in respect of third party intellectual property (unless the terms of the licences prohibit the Institution from doing so)[547] so that the bidders can satisfy themselves as to any consent they may need from the licensors. Assuming that all necessary consents are obtained from the licensor so that the Private Party is permitted to use the Licensed Intellectual Property, the PPP Agreement should include reasonable limitations relating to the abuse of those use rights by the Private Party and also indemnities to protect the Institution against such abuse. These Private Party indemnities should also reflect the prescribed approach.

82.3 **Intellectual Property Rights on Termination and Expiry**

82.3.1 The PPP Agreement will also need to deal with what happens to Intellectual Property at the end of the Project Term (that is, both on termination and expiry of the PPP Agreement). The following principles generally apply.

82.3.2 All Intellectual Property (if any) belonging to the Private Party must be transferred to the Institution. All use rights of the Private Party (and/or any Subcontractor) in respect of Intellectual Property (if any) made available by the Institution to the Private Party, including any Licensed Intellectual Property, must be relinquished.

82.3.3 In the case of any Licensed Intellectual Property procured by the Private Party, the Institution should be entitled to a perpetual licence to use any such Licensed Intellectual Property if it is Customised Intellectual Property. This licence should allow the Institution (or its nominee) to use such Customised Intellectual Property either:

82.3.3.1 for the continued performance of the same institutional function previously performed by the Private Party through the Project Deliverables, *free of any future royalties* on the assumption that the Institution would have paid for such Intellectual Property in full

[547] Typically these licences will impose confidentiality restrictions and, if they do, the Institution should first obtain the consent of the licensor to the disclosure of these licences.

through the Unitary Payments and/or the termination compensation. Here the Institution (and its nominee) would not be entitled to use the Intellectual Property in the performance of any other institutional function or for any other purpose; or

82.3.3.2 for the continued performance of the same institutional function previously performed by the Private Party through the Project Deliverables *and* for any other purposes (whether in similar projects or in any other projects). Here the Institution should expect that such *extended* use rights might come at a price.

The choice between these alternatives will depend on which provides better value for money.

82.3.4 In respect of Licensed Intellectual Property that is not Customised Intellectual Property but is nevertheless required for the continued performance after the termination or expiry of the Project Term of the institutional function previously performed by the Private Party, the Private Party must be under an obligation to ensure that the Institution is entitled to use such Licensed Intellectual Property as aforesaid either itself or through a nominee. Such use rights must also be secured for any Institution step-in period. The Private Party should also ensure that any royalties payable by the Institution for the use rights in the period following the *expiry* of the PPP Agreement should be at reasonable commercial rates. It is for the Private Party to ensure that the licences that it (or any Subcontractor) concludes in respect of such Licensed Intellectual Property reflect these entitlements. The Institution must seek an indemnity from the Private Party in respect of any direct losses it might incur if it is not entitled to use such Licensed Intellectual Property either directly or through a nominee. Thus, if the Private Party chooses to use proprietary third party software in the operation of any Facilities used in the performance of the Project Deliverables, it must bear the risk of the third party not agreeing to the Institution (or its nominee) using such software during any Institution step-in period or after the termination or expiry of the Project Term. Similarly, the Private Party must bear the risk of the third party licensor being prevented from permitting the Institution (or its nominee) to use the Licensed Intellectual Software because of restrictions imposed by that licensor's government. If the Private Party is reluctant to bear those risks, then it should find alternative intellectual property that is capable of being used by the Institution (or its nominee).

82.3.5 In addition, arrangements should wherever possible be put in place to ensure that the Institution has immediate access to any information and materials required to use the Intellectual Property. In this regard, it is prescribed that the source codes of all software products used in the operation of the Facilities should be held in trust (sometimes referred to as "in escrow") by an independent party, and the Institution (or its nominee) should be entitled to have access to any source code whenever it becomes entitled to the Intellectual Property to which it relates.[548]

82.3.6 It should also be noted that a New Private Party would need access to all such information and materials as well as the Intellectual Property in advance of the conclusion of the New PPP Agreement in order to acquaint itself with the Project Deliverables and facilitate the smooth hand over to it of the Facilities.[549] These access rights should be negotiated in advance rather than being left to be resolved on termination of the PPP Agreement.

82.4 **Intellectual Property of the Institution**

The uses of the Institution's own intellectual property by the Private Party also needs to be provided for in the PPP Agreement.

[548] Source codes are particularly critical for the upgrade of software, which may prove to be more cost-effective than buying new software. Given the extended duration of PPPs, software upgrades will probably be unavoidable.

[549] The Lenders will have the same concerns in relation to the Substitute Private Party.

Standard Clause[550]

Intellectual Property of the Institution

(a) All intellectual property rights whatsoever, whether capable of registration or not, regarding the Institution's name, trademarks, logos, image and all other intellectual property matters relating to the Institution, including its name, trademarks, logos and/or image shall remain the sole property of the Institution.

(b) Subject to existing rights and obligations and Clause (c), the Institution shall, on prior written application by the Private Party, grant a non-exclusive revocable right and licence to the Private Party to use the Institution's trademarks and logos for a period not to exceed the remainder of the Project Term.

(c) In order to establish and maintain standards of quality and propriety acceptable to the Institution, in the event that the Private Party desires to use the Institution's trademarks or logos in any way, the Private Party shall first submit the concept or a sample of the proposed use to the Institution for approval, which shall be in its sole and absolute discretion. The Institution shall use reasonable endeavours to advise the Private Party of its approval or disapproval of the concept or sample within [x] Business Days of its receipt of the concept or sample. If the Institution approves the concept or sample, the Private Party shall not depart therefrom in any respect without the Institution's further prior written approval.

(d) If at any time the Institution revokes its approval for the specified use of any trademark or logo, the Private Party shall forthwith discontinue all use of such trademark or logo and shall remove from public sale or distribution any previously approved product in respect of which the Institution has revoked its approval. The costs incurred by the Private Party as a result of such revocation shall be borne by the Private Party if the grounds for the revocation include any ground described in Clause (e).

(e) The Institution may revoke its approval immediately upon [x] Business Days written notice to the Private Party if the Private Party, any Subcontractor or any of its or its Subcontractors' officers, directors or employees commits any crime or otherwise engages in conduct which violates any law, or engages in any conduct that offends against public morals and decency and, in the Institution's reasonable opinion, materially prejudices the reputation and public goodwill of the Institution.

(f) The Private Party acknowledges that the name(s) of the Institution (the "Protected Names") are associated with and peculiar to the Institution and are the intellectual property of the Institution. Consequently, the Private Party agrees that the sole and exclusive ownership of the Protected Names shall vest in the Institution.

[550] This Standard Clause only relates to the Intellectual Property of the Institution (in the nature of its name, trademarks, logos, image and the like) made available to the Private Party. If the intellectual property includes information technology or business secrets or the like, this Standard Clause will need to be supplemented.

(g) *In circumstances where the Private Party utilises any of the Protected Names, either on its own or in combination or association with any other name, it does so only in terms of this PPP Agreement and with the prior approval of the Institution. On termination or expiry of this PPP Agreement, the Private Party shall not be entitled to operate or conduct any business using any of the Protected Names either on its own or in combination or association with any other name.*

(h) *Within [x]Business Days after the end of the Project Term and where the Private Party has operated a company utilising any of the Protected Names with the permission of the Institution, the Private Party shall either:*

  (i) *de-register the company bearing any of the Protected Names; or*

  (ii) *change the name to a name not substantially similar to any of the Protected Names.*

(i) *The naming of the Private Party's business operation shall be undertaken in consultation with the Institution and subject to the Institution's approval. In circumstances where the name chosen by the Private Party and approved by the Institution is not part of the Institution's intellectual property, then the rights of the Institution contemplated in Clause (h) shall not be applicable and the intellectual property shall be the sole property of the Private Party.*

PART S: MISCELLANEOUS

83 ASSIGNMENT, SUBCONTRACTING AND CHANGES IN SHAREHOLDING AND CONTROL

83.1 Assignment

83.1.1 In our law a contracting party:

83.1.1.1 may freely cede its contractual rights to a third party without the consent of the other contracting party, unless their contract prohibits such cession; and

83.1.1.2 may not delegate its contractual obligations to a third party unless the contract permits such delegation.

83.1.2 It is common practice for contracting parties to specifically agree in their contract that neither of them may cede its contractual rights or delegate its contractual obligations (the terms "cede" and "delegate" being collectively referred to as "assign") without the prior consent of the other. This restriction provides each contracting party with a means to prevent the exit of a party it has identified as a suitable partner and the entry in its place of a new contracting party whom it may not know or may even consider to be unsuitable.[551]

83.1.3 In long-term contracts such as a PPP, some parties may, however, not want to have their exit restricted in any way and accordingly may require the flexibility to proceed with an assignment of their rights and obligations without the consent of the other parties. This flexibility should not generally be allowed in a PPP save as permitted below.

83.1.4 The PPP Agreement should not allow the Private Party to assign its rights and obligations, or even merely to cede its rights under the PPP Agreement, except as part of the Lenders' security package as

[551] This contractual restriction is not inviolable. For instance, corporate parties intent on exiting can do so at parent company level. Accordingly, additional protections will need to be built into a contract to give effect to the exit restrictions.

reflected in the Direct Agreement. Given, however, that a Substitute Private Party may be appointed in accordance with the Direct Agreement, the PPP Agreement should allow for the original Private Party's rights and obligations under the PPP Agreement to be assigned to the Substitute Private Party.

83.1.5 Similarly, the PPP Agreement should not allow the Institution to assign its rights and obligations or even merely to cede its rights under the PPP Agreement. The Parties should, however, be aware that such assignment may occur by "operation of law" where an Institution's functions are vested by statute in another entity (for example, where a department or a business activity conducted by it is "corporatised" through the formation of a company or similar entity). Typically, such statutes will provide specifically that the contracts of the original Institution will be vested in the other entity as if the latter had entered into those contracts. The Private Party (and its funders) may seek to be protected against such "automatic" assignments in circumstances where the other entity is a new entity, based on a concern that the other entity may not have the capacity to meet the original Institution's financial obligations under the PPP Agreement. However, this concern is misplaced given that the assignment of institutional functions to another government entity will be accompanied by the allocation of the budget for those functions to the other entity (simply stated, "budget follows function"). In any event, contracting parties cannot avoid a mandatory statutory assignment of institutional functions. Therefore, if a Private Party seeks to be protected against such an assignment by requiring, for instance, a right to terminate on the basis that such assignment is a "deemed" Institution Default, this should be rejected.

83.1.6 Institutions sometimes wish to limit the ability of Lenders to transfer their rights in respect of the Project. However, Institutions should not attempt to interfere in the identity of Lenders.[552] If Institutions have particular

[552] Exempt Refinancings (which require prior notification to, but no approval from, the Institution) include any syndication, sell-down or grant of rights to co-finance by any Lenders to any Qualifying Financial Institutions.

concerns about issues, such as whether confidentiality will be maintained following a transfer, these can be dealt with in the specific clauses dealing with those issues.

Standard Clause

Assignment

(a) *This PPP Agreement and any Project Document to which both the Institution and the Private Party are parties shall be binding on, and shall enure to the benefit of, them and their respective successors-in-title and permitted transferees and assigns.*

(b) *Save as expressly permitted hereunder and under the Direct Agreement, the Private Party shall not, without the prior written approval of the Institution, assign, cede, delegate, transfer or otherwise dispose of any right or obligation under this PPP Agreement or any Project Document to which it is a party to any other person.*

(c) *The Institution shall not assign, cede, delegate, transfer or otherwise dispose of any right or obligation under this PPP Agreement or Project Document to which it and the Private Party are parties to any other person, save with the prior written approval of the Private Party (such approval not to be unreasonably withheld or delayed) or to give effect to any mandatory requirement of any applicable law.*

83.2 **Subcontracting**

83.2.1 The Institution may feel that it must exercise a large degree of control over all the subcontractors, whether at the first-tier or second-tier levels, through so-called "collateral warranties" or direct undertakings from them. This applies to the *performance* of subcontracted Project Deliverables and the replacement of the subcontractors. On the other hand, the Private Party believes that since it is at risk for subcontractor defaults, it should be entitled to decide on the replacement of the subcontractors without interference by the Institution.

83.2.2 In general, any attempt by the Institution directly to control the *performance* by the subcontractors (whether at the first-tier or lower levels) of the subcontracted Project Deliverables is discouraged as it will dilute the level of risk transfer to the Private Party and, further, is unnecessary given the protections afforded the Parties under the PPP Agreement.

83.2.3 The Institution should ensure that all performance obligations in respect of the Project Deliverables are retained by the Private Party, *vis a vis* the Institution, and should look to the remedies it has against the Private Party under the PPP Agreement (for example, the Penalty Deduction regime) to ensure proper performance by the subcontractors. However, in some limited cases there may be special reasons why the Institution should have a degree of control over the performance of the subcontractors. For example, there may be public health and safety issues or national security concerns, such as in a hospital or prison project, or the Institution may have a statutory duty that it must perform.[553] In those cases, the degree of control must be reasonable.

83.2.4 On the other hand, the Institution should always be entitled to pre-approve the selection and appointment of all replacement first-tier Subcontractors, although it should have to do so with reference to objective and specified criteria.

83.2.5 These pre-approval criteria should be that the replacement Subcontractor:

83.2.5.1 has the appropriate technical and financial ability to perform the obligations of the original Subcontractor under the relevant Subcontract;

83.2.5.2 employs persons having appropriate qualifications, experience and technical competence; and

83.2.5.3 has sufficient resources available to it (including committed financial resources and contracts) to perform the obligations of the original Subcontractor under the relevant Subcontract.

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[553] The Institution should not, however, seek to control who the Private Party and its Subcontractors employ in the performance of the Services except where there are valid reasons for doing so, such as empowerment equity goals. These should, however, be specified in the PPP Agreement and should be objectively measurable.

The appointment of the replacement Subcontractor should also be conditional on the replacement Subcontractor having the necessary legal power and authority to become a party to the Subcontract, its directors not having any criminal convictions, it not having any outstanding tax liabilities (save for any such liability which is the subject of a *bona fide* dispute) and it meeting all specified empowerment criteria (which should at least be the same as for the original Subcontractor). The Institution should obtain appropriate assurances (such as warranties or similar undertakings) from the Private Party in this regard as a precondition for the grant of its approval.

83.2.6 If the PPP Agreement also includes requirements for subcontractors at the second-tier to meet any empowerment criteria, then the Institution should obtain appropriate assurances from the Private Party that the replacement second-tier subcontractors meet these empowerment criteria as a precondition for the grant of its approval.

83.2.7 The PPP Agreement should contain a procedure to be followed by the Parties when the Institution needs to consider any proposed replacement first-tier Subcontractor which it must approve. This procedure should not be one where the Institution's approval is deemed to be given if the Institution fails to respond within a particular time unless there are also provisions requiring the Private Party to give the Institution some notice after which the Institution has additional time (albeit a short period) to decide on whether or not it wishes to give its approval. Institutions should, however, be cognisant of the Private Party's programme for performing the Project Deliverables and should therefore ensure that its approvals are not unreasonably delayed, by making sufficient capacity available and implementing suitable arrangements. To facilitate this and comply with its obligations under the Treasury Regulations, the Institution should ensure that the Project Officer designates an official to be the "project champion" and supervises all the subcontracting arrangements including the approval process.

83.3 Changes in Shareholding and Control

83.3.1 An Institution may be concerned about changes in the Shareholders and their respective shareholdings. If this is the case, then the Institution may seek to impose restrictions on the ability of the Shareholders to transfer their shareholdings in the Private Party or to otherwise change their shareholdings (for instance, through new subscriptions for shares). These restrictions can be effected indirectly (given that the Shareholders are not party to the PPP Agreement) by providing in the PPP Agreement for the penalty regime or default regime to be triggered if an unapproved change in shareholding occurs. The Shareholders may well object to these restrictions.

83.3.2 Imposing a restriction on the Shareholders' ability to change their interests (Equity and Shareholder Loans) in the Private Party is partly to prevent any person which the Institution thinks is unsuitable from becoming involved in the Project, partly because the Institution takes comfort from the commitment reflected by the original Shareholders continuing to keep their economic stake in the Project, partly because South African procurement law requires that the Private Party be selected in a fair and transparent process (which could be frustrated by allowing subsequent changes in the Shareholders) and partly because the Institution wishes to ensure that the BEE targets for Black Equity[554] are complied with.

83.3.3 Generally, the Institution's prior approval should not be required for any change in shareholding in the Private Party, unless such change effects a "change in control" or dilutes the Black Equity in the Private Party, or for any change that effects the exit of a Shareholder whose involvement is no longer vital at the time of the exit (for example, a Shareholder related to the Construction Subcontractor who wishes to exit after construction completion and once Service Commencement has begun).

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[554] See Part M:56 (*Black Economic Empowerment: Black Equity in the Private Party*).

83.3.4 There is no generally accepted meaning of "change in control". Accordingly, an Institution will have to ensure that the PPP Agreement contains a definition of "change in control". In this regard, the Institution should bear in mind that it is not always possible to establish (even by undertaking a reasonably thorough due diligence) who "actually" owns (in the sense of "beneficially" or "benefiting from") shares in a company as the registration of a shareholding in the share register of a company could be effected in the name of a "nominee". Accordingly, the definition of "change in control" and the procedure for notifying all changes in shareholding should be directed to "beneficial" and not just "registered" ownership.

83.3.5 Institutions should also recognise that the Lenders have legitimate interests in limiting permitted changes of control of the Private Party and in requiring some commitments from the Shareholders (and their holding companies) to maintain their shareholdings and economic stake in the Project at least for some minimum period (usually not ending before they have invested all their Equity and Shareholder Loans in the Project). The Institution should not use its approval right in a way that will interfere with the ability of the Lenders to protect their legitimate concerns.

83.3.6 In some projects, the Institution may also require that there is a passing of control in the Private Party to the Black Shareholders at some future point. Where this is the case, this should be made clear when bids are invited, and the requirements should be clearly set out in the PPP Agreement.[555]

83.3.7 The consequences of a change of control that is not permitted should also be clearly specified in the PPP Agreement. Typically a change of control that is not effected in accordance with these requirements will be a

[555] See Part M:56 (*Black Economic Empowerment: Black Equity in the Private Party*).

Private Party Default and is considered to be so serious that it will entitle the Institution to terminate the PPP Agreement.[556]

83.3.8 The PPP Agreement may also include:

83.3.8.1 a detailed procedure that will enable the Institution to know when there has been a change in control. Thus it may not be enough simply to require the Private Party to give the Institution notice of an intended change. It might, for example, also be necessary for the Institution to require:

(a) the Private Party to insert provisions in its articles of association that refer to the change restrictions in the PPP Agreement and that require that all share certificates issued by the Company contain appropriate endorsements reflecting these transfer restrictions;

(b) that the share certificates of the Shareholders be held by a third party (in trust) so that they cannot be freely transferred by the Private Party. The Institution should bear in mind that the Lenders will typically take security over the Equity and the Shareholder Loans and may also therefore require that the share certificates relating to the Equity be deposited with the Lenders' Agent (or any security company, trust or other entity appointed by the Lenders to hold their security for the Debt). If this is the case, then the Institution should not require that these share certificates be deposited with it or its nominee and should instead (if this will provide comfort for the Institution) agree with the Lenders that the Lenders' Agent (or the security company, trust or other entity, as the case may be) will notify the Institution of any changes in the deposit arrangements and any release of such certificates. This agreement may be incorporated in the Direct

[556] See, for example, the provisions in the Standard Clauses in Part N:60.3.3 (*Termination for Private Party Default*).

Agreement, which may also include provision for the Lenders' Agent (or the security company, trust or other entity, as the case may be) to hand over the share certificates to the Institution when the Debt is discharged; and/or

(c) for the Institution to be entitled to require from time to time that it be given copies of or access to certain documents (such as the Private Party's share register) to satisfy itself that there has been no change in control that it has not approved; and

83.3.8.2 a detailed procedure for the giving of the necessary approval by the Institution.

Standard Definitions

*"**Change in Control**" means any change whatsoever in Control whether effected directly or indirectly;*

*"**Control**" means, in relation to any entity, the ability directly or indirectly to direct or cause the direction of the votes attaching to the majority of its issued shares or interests carrying voting rights, or to appoint or remove or cause the appointment or removal of any directors (or equivalent officials) or those of its directors (or equivalent officials) holding the majority of the voting rights on its board of directors (or equivalent body).*

Standard Clause

<u>*Changes in Control and Black Equity*</u>

(a) For the duration of the Project Term [(save as otherwise provided in Clause (b))], the Private Party shall procure that there is no Change in Control in the Private Party (or in any company of which the Private Party is a subsidiary) without the prior written approval of the Institution.

(b) [[Prior to the expiry of a period of [x] months commencing on the Service Commencement Date], the Private Party shall procure that there is no sale, assignment, cession, transfer, exchange, renunciation or other disposal of the whole or any part of the Equity and/or the Shareholder Loans, nor any dilution of the

Equity, of [x] (or of any company of which [x] is a subsidiary) without the prior written approval of the Institution.[557]]

(c) *The Private Party shall procure that for the duration of [period]:[558]*

(i) *[subject to the Lenders' rights in respect of any security held by them (or any agent acting on their behalf, or any security company, trust or other entity holding any security in respect of the Debt for the benefit of the Lenders)] there is no sale, assignment, cession, transfer, exchange, renunciation or other disposal (at any time) of the whole or any part of the Equity and/or the Shareholder Loans of any Black Shareholder other than to another Black Shareholder, Black Person or Black Enterprise;*

(ii) *there is no dilution in the aggregate Equity holdings of the Black Shareholders below the Minimum Black Equity[559]; and*

(iii) *there is no Change in Control (at any time) in any Shareholder that is a Black Enterprise, which will result in that Shareholder no longer being a Black Enterprise.*

(d) *For the purpose of this Clause [x] (Changes in Control and Black Equity), the term "subsidiary" shall have the meaning as defined in the Companies Act, 1973.*

84 THIRD PARTIES

84.1 It is important for the Parties to remember that a written contract only binds those people who have signed the contract. Generally therefore, everyone who should be bound by a contract must sign it, after obtaining all necessary approvals (for example, in terms of the PFMA).

84.2 As such, no provisions should be included in any contract which are intended to impose obligations on any third parties who are not parties to the contract.

84.3 There is only one exception to this. South African law does allow rights or benefits to be given in a contract to a person who is not a party to the contract at the time when it is concluded. This is sometimes referred to by its Latin

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557 This Standard Clause relates to a Shareholder who will not play a key role in the Project after the "lock-in" period (or is a Shareholder of an entity, such as a Subcontractor, who will not play a key role). The length of the lock-in period will depend on the Project concerned.

558 Specify the Black Equity lock-in period. In this regard see Part M:56 (*Black Economic Empowerment: Black Equity in the Private Party*).

559 See Part M:56 (*Black Economic Empowerment: Black Equity in the Private Party*).

name *"stipulatio alteri"* (for the purposes of these *stipulatio alteri* provisions, benefits are really the same as rights).[560] Sometimes, when this process is used, the person receiving those benefits is also required to accept some obligations. In such a case, it must be made clear what these are and it must be stated in the contract that if that person accepts the benefits, then that person must also accept the obligations at the same time. The contract should then clearly set out the process required for that person to accept those benefits (and where applicable, obligations). It is not desirable for there to be a statement that the person concerned is "deemed" somehow to have accepted those rights (and, where applicable, obligations). There should be a definite actual acceptance. These rights should also not be able to be accepted on behalf of the person concerned by someone else, unless at the time when the contract with those provisions was concluded, there was already a clear and express appointment in place giving that representative the authority and power to accept those rights (and, where applicable, obligations) on behalf of that person.

84.4 The use of these *stipulatio alteri* provisions should be limited as far as possible. The best way to give a person rights and obligations under a contract is for that person to be bound as a party to the contract together with all the other parties at the same time as they all become bound.

84.5 In PPPs, the most common circumstances where third parties might be given rights and obligations is where the Lenders are given the right to step-in and attempt to remedy breaches by the Private Party of its obligations. These may be dealt with using the *stipulatio alteri* mechanism, but the prescribed approach is rather for these rights and obligations to be contained in a Direct Agreement with the Lenders (see Part O:74 (*Step-in: Standard Direct Agreement*)).

[560] See also footnotes 87 and 488 and the Standard Clause in Part N:70 (*Termination: Payment Procedure*).

85 TAXATION

85.1 The general principle for PPP Agreements should be that the Private Party is liable for any taxation applicable to its income or activities, this risk not being transferred to the Institution.

85.2 Generally, therefore, the PPP Agreement should not provide that the Institution must pay more if the Private Party does not receive the amounts which it expected because of the introduction of additional or new taxes, particularly withholding taxes (this provision is often called a "gross-up" clause). The Institution does not control the tax policies or laws in South Africa, and there is no reason for the risk of changes in those tax policies or laws to be borne by it.

85.3 An exception to this may arise if the Institution does control changes in tax policies or laws, or where there are unforeseeable changes in tax policies or laws which specifically discriminate against the Private Party so that it is dealt with differently from other persons carrying on similar activities.[561]

85.4 Private Parties may feel that they should be entitled to some additional payments because under their agreements with their funders they must increase their payments to their funders in instances where there are changes in taxation affecting the amounts the funders receive on their loans. However, the positions of the funders and of the Private Party are not the same in this regard, and risks arising from unforeseeable changes in tax law that apply generally should be borne by the Private Party. Risks arising from changes that are discriminatory and specific to the Private Party should be dealt with in the PPP Agreement provisions dealing with unforeseeable discriminatory government conduct.

85.5 The PPP Agreement should expressly state whether amounts payable by either Party under the PPP Agreement are exclusive or inclusive of VAT.

[561] See Part K:49 (*Unforeseeable Discriminatory Government Conduct and Variations: Unforeseeable Discriminatory Government Conduct*).

86 DISPUTE RESOLUTION

86.1 General

86.1.1 The PPP Agreement must specify a procedure for handling disputes under the terms of the PPP Agreement.

86.1.2 It is often argued by the Private Party (and particularly its funders) that resolving disputes under a contract by means of normal litigation processes (that is, through the courts) is too slow, too expensive and sometimes even "unreliable" as the courts may lack the expertise necessary to adjudicate the technical and financial complexities of PPP Agreements. They usually argue therefore that arbitration by specified arbitrators is the best dispute resolution regime for PPP Agreements.[562]

86.1.3 However, these arguments are not sustainable for the following reasons. There is no inherent or automatic benefit in arbitration since arbitration is not necessarily quicker or cheaper than litigation through the courts. The rules of court permit the appointment of technical and financial experts to assist judges in regard to matters that require expert consideration. The private negotiated selection of arbitrators does not ensure the selection of the most able persons for such appointments and, in so far as such selection is not an open process or otherwise subject to the regulatory checks inherent in the process of judicial selection, may even be tainted by claims of nepotism. But the most compelling reason for the preference for curial adjudication over arbitration is the need to build up a substantial legal precedent base for the interpretation and enforcement of PPP Agreements, to provide the courts with the opportunity to grow the expertise required to deal with the complexities of PPP Agreements and to promote a measure of transparency regarding the interpretation and enforcement of PPP Agreements.

[562] If arbitration is selected for the resolution of any disputes under a contract, then the parties would also consider whether some or all the provisions of the Arbitration Act, 1965 (such as those governing the appointment of arbitrators, the conduct of arbitration proceedings, the making of arbitral awards and the remuneration of the arbitrator) should apply to the arbitration. In terms of that Act, unless the parties agree otherwise, arbitral awards are not appealable.

86.1.4 Accordingly, the prescribed approach for disputes arising in connection with PPP Agreements is for these to be settled ultimately through the courts, except in the case of any specific categories of dispute requiring fast-track dispute resolution by expert adjudicators. Further, alternative forms of dispute resolution processes such as informal conciliation must first be attempted.

86.1.5 Alternative forms of dispute resolution endeavour to have the dispute resolved "amicably", that is by agreement between the affected parties rather than by the imposition of some external decision. The prescribed alternative form of dispute resolution involves informal conciliation through internal referrals up a ladder of increasingly senior levels of the Parties (all the way up to the chief executive officer or board of directors (or equivalent authority)).[563] If these informal attempts fail, then the dispute should be decided by means of litigation in the courts, save in the case of disputes for which fast-track dispute resolution is specified.

86.1.6 A fast-track dispute resolution process is included in the PPP Agreement to deal with urgent issues which cannot be delayed by, among other things, the wait for a court date or with clear "non-legal" issues that do not justify lengthy and expensive curial procedures to be resolved.

86.1.7 Sometimes the dispute between the Institution and the Private Party involves issues which are also matters of dispute between the Private Party and one or more of its Subcontractors or another third party. If common issues are involved, it may seem practical to join all the disputing parties in one proceeding. Joinder of a third party is also unavoidable (by operation of law) in curial proceedings where that third party is a "necessary party", that is, it has a direct and substantial interest in any order that might be made or where such order cannot be carried

[563] Another form of dispute resolution not favoured in this Standardisation is mediation. This is where a neutral third party attempts to help the disputing parties to resolve their dispute but has no power to impose a binding solution. Mediation is not preferred because it is not likely to produce any better results than internal referral.

into effect without prejudice to that third party.[564] Where a third party is not a "necessary party", joinder can be effected (so-called joinder of convenience) with the consent of the primary parties to the dispute, but this is not the best way to proceed in PPPs. For the Institution, joinder of a Subcontractor who is not a "necessary party" to the dispute will increase the time, effort and cost of resolving its dispute with the Private Party.[565] Accordingly, the prescribed approach is for the Institution not to agree upfront to joinder of parties (subject to applicable law) but rather to consider this issue only where the dispute arises and then to take legal advice about the benefits of joinder.

86.1.8 Private Parties sometimes endeavour to include disputes between them and the Institution under the list of Relief Events provided for in the PPP Agreement so that they do not have to continue performing the Project Deliverables until the disputes are resolved. This issue arises especially during the construction phase. This should be resisted. The Private Party (and the Subcontractors) should not be permitted to stop performing the Project Deliverables simply because a dispute has arisen. The design, engineering and construction contractors should be very familiar, through the work which they ordinarily do, with these principles, and should know how to organise themselves so that they can continue as far as possible with their work.

86.1.9 The Private Party must be under an obligation to continue with the Project Deliverables in accordance with the PPP Agreement while any dispute is unresolved, even if this involves building or covering over construction works which may need rebuilding or opening up if the dispute is resolved in the Private Party's favour. The Private Party must rely on the dispute resolution procedure providing adequate compensation to it if the dispute is resolved in its favour.

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[564] Such joinder of necessity is not dependent on the discretion of the court, which is duty bound (by common law and the rules of court) not to proceed without the joinder of the third party unless there is clear evidence that the third party has waived its rights to joinder.

[565] In addition, given the allocation of subcontractor risk to the Private Party, the Institution should avoid becoming caught up in the Private Party's disputes with its Subcontractors.

86.1.10 The Institution should recognise that if the dispute is resolved in the Private Party's favour, the Institution will typically be liable for the Private Party's costs. These could include any extra costs incurred in rebuilding (such as staff costs and materials costs) and any resulting costs incurred by the Private Party if a delay to commencement of the Services results.

Standard Clause

Dispute Resolution

(a) Referable Disputes

The provisions of this Clause [x] (Dispute Resolution) shall, save where expressly provided otherwise, apply to any dispute arising in relation to or in connection with any aspect of this PPP Agreement between the Parties.

(b) Internal Referral

(i) If a dispute arises in relation to any aspect of this PPP Agreement, the Parties shall attempt in good faith to come to an agreement in relation to the disputed matter, in accordance with the following informal process:

(aa) all disputes shall first be referred to a meeting of the [liaison officers or other designated executives from each Party who are actively involved in the Project, and have sufficient authority to be able (if necessary with consultation back to their respective organisations) to resolve it]; and

(bb) if the Parties have been unable to resolve the dispute within [x] days of referral to [the persons specified in Clause (b)(i)(aa)], either Party may refer the dispute for a decision by the [Accounting Officer / Accounting Authority of the Institution] and the [Chief Executive Officer or equivalent officer] of the Private Party.

(ii) In attempting to resolve the dispute in accordance with the provisions of this Clause (b), the Parties shall (and shall procure that their employees and representatives shall) use reasonable endeavours to resolve such dispute without delay by negotiations or any other informal procedure which the relevant representatives may adopt. Those attempts shall be conducted in good faith in an effort to resolve the dispute without necessity for formal proceedings.

(iii) Any dispute which has not been resolved by the representatives contemplated in Clause (b)(i)(bb) within [x] days of the dispute being referred to them (or any longer

period agreed between the Parties) shall be treated as a dispute in respect of which informal resolution has failed.

(c) Performance to Continue

No reference of any dispute to any resolution process in terms of this Clause shall relieve either Party from any liability for the due and punctual performance of its obligations under this PPP Agreement.

(d) Litigation

(i) Save where any dispute has been expressly referred for determination in terms of Clause [x] (Fast-Track Dispute Resolution), if informal resolution of any dispute has failed, then the dispute may be referred to litigation in the courts by either Party.

(ii) Neither Party is limited in any proceedings before the court to the information, evidence or arguments used in the informal attempts to resolve the dispute.

86.2 **Fast-track Dispute Resolution**

86.2.1 In many contracts, the parties may sometimes wish to have certain disputes determined by independent experts. For example, the Parties may agree that disputes concerning the calculation of any Refinancing Gains, or the application of any inflation-indexation mechanism, or the application of the economic test to determine whether the proceeds of the material damage insurances should be applied to reinstate the Project, be resolved on a fast-track basis by an independent financial expert.

86.2.2 The prescribed position is that any such independent expert should be appointed by agreement between the Parties in the PPP Agreement itself and not by either of the Parties alone. If the Parties cannot agree on the identity of that expert, then provision should be made for an appropriate third party to make the appointment. The relevant clause should clearly set out the procedure for the appointment of the expert and the terms of the expert's mandate. Depending on the nature of the project there may well be a need for the appointment of several Independent Experts. The number of Independent Experts should be determined on a project-by-project basis. Where there is more than one Independent Expert, the PPP Agreement should incorporate a Schedule allocating the appropriate Independent Expert to each dispute or category of disputes. Alternatively, every provision in the PPP Agreement expressly referring a matter for Fast-track Dispute Resolution should also expressly identify the appropriate Independent Expert. Provision should also be made for payment of the costs of each Independent Expert.

86.2.3 One of the practical issues that needs to be addressed in the selection of an appropriate Independent Expert for any dispute or category of disputes, is that given the long-term nature of PPPs the selected expert may not always be available, whether through resignation, death, insolvency, dissolution or otherwise or, for instance, where because of changes in circumstances after the Project has commenced that expert has developed a conflict of interest thereby creating uncertainties regarding its impartiality. Accordingly, the PPP Agreement must make provision for the expeditious appointment of alternates in cases of unavailability and potential conflicts of interest. To save time, the PPP Agreement may specify a "panel" of experts for appointment as the Independent Expert and if so should specify a procedure for the selection of the Independent Expert from that panel. That procedure could include a rotational system providing for the periodic rotation of the experts on the panel, so that at the commencement of each period, the expert designated in the rotation schedule shall automatically be appointed as the Independent Expert for that period, unless it is unavailable or disqualified, in which case the next expert on the schedule will be the Independent Expert, and so forth.

86.2.4 The prescribed position is also that the Independent Expert's determination will be final and binding on the Parties. However, where the Parties wish to make provision for the Independent Expert's decision, if disputed, to be "appealable", then such dispute should fall into and be dealt with in the ordinary dispute resolution clause with no special mechanism needing to be created.

Standard Clause

<u>Fast-track Dispute Resolution</u>

(a) Disputes expressly referred for determination pursuant to this Clause [x] (Fast-track Dispute Resolution) shall be determined by the [relevant][566] Independent Expert.

(b) Within [five] Business Days after a dispute has been referred by either Party to the appropriate Independent Expert, the Independent Expert shall require the Parties to submit in writing their respective arguments. The Independent Expert shall, in his/her absolute discretion, consider whether a hearing is necessary in order to resolve the dispute.

(c) It shall be entirely within the power and competence of the Independent Expert to decide upon any matters related to the proper preparation of the dispute for hearing and in that regard the Independent Expert shall direct the Parties accordingly.

(d) The Independent Expert shall set the date for the hearing, choose the venue (which must be a venue in South Africa)[567] for the hearing and determine all matters regarding any aspect of the hearing. Moreover, the Independent Expert can decide whether at the hearing the Parties are to give oral evidence or confine themselves to presenting their cases in writing or by some other appropriate procedure. In this regard, the Independent Expert must be guided by considerations of fairness, the cost-effective resolution of the dispute, and the need to resolve the dispute quickly.

(e) The Independent Expert shall provide both Parties with his/her written decision on the dispute, within [20 (twenty)] Business Days of the referral (or such other period as the Parties may agree after the referral). The Independent Expert shall give his/her reasons for the award, if so requested by either Party.

(f) The Independent Expert's costs of any referral shall be borne as the Independent Expert shall specify or, if not specified, equally by the Parties. Each Party shall bear its own costs arising out of the referral, including its legal costs and the costs and expenses of any witnesses.

(g) The Independent Expert shall act impartially and may take the initiative in ascertaining the facts and the law. The Independent Expert need not strictly observe the principles of law and may decide the matter submitted to him/her in accordance with what he/she considers equitable in the circumstances.

(h) Should the need arise for either Party to seek interim or temporary relief before the adjudication is finalised, that Party

[566] See Section 86.2.2 and Section 86.2.3.

[567] In the case of provincial Institutions, the PPP Agreement must specify the relevant Province.

may apply to the Independent Expert to grant such interlocutory order or give the required temporary relief and the Independent Expert shall have the same power to do so as if the matter were one heard by a Judge in the High Court of South Africa, save that if by law such power or order cannot be exercised or given by an Independent Expert then, and then only, should the Parties refer such matter to such High Court.

(i) *The proceedings shall be confidential and all information, data or documentation disclosed or delivered by either Party to the Independent Expert in consequence of or in connection with his/her appointment as Independent Expert shall be treated as confidential. Neither the Parties nor the Independent Expert shall, save as permitted by Clause [x] (Confidentiality) of this PPP Agreement, disclose to any person any such information, data or documentation unless the Parties otherwise agree in writing, and all such information, data or documentation shall remain the property of the Party disclosing or delivering the same and all copies shall be returned to such Party on completion of the Independent Expert's work.*

(j) *The Independent Expert is not liable for anything done or omitted in the discharge or purported discharge of his/her functions as Independent Expert, unless the act or omission is grossly negligent or in bad faith. Any employee or agent of the Independent Expert is similarly protected from liability.*

(k) *Should any Party fail to co-operate with the Independent Expert with the result that in the view of the Independent Expert such default or omission prejudices the adjudication process, then the Independent Expert can either:*

(i) *give that Party written notice that unless it remedies the default or omission within a given time, it will forfeit the right to continue to participate in the adjudication; or*

(ii) *warn the Party in writing that its default or omission may make it liable to a punitive order of costs irrespective of whether it succeeds in the adjudication or not and such punitive award of costs may include an order of attorney and client costs or attorney and own client costs as those expressions are understood in the Uniform Rules of Court.*

(l) *The Independent Expert shall be deemed not to be an arbitrator but shall render his/her decision as an expert and the provisions of the Arbitration Act, 1965 and any other law relating to arbitration shall not apply to the Independent Expert or his/her determination or the procedure by which he/she reaches his/her determination. The Independent Expert's decision shall be final and binding on the Parties.*

87 GOVERNING LAW AND JURISDICTION

This will be a relatively standard provision.

Standard Clause

Governing Law and Jurisdiction

(a) *This PPP Agreement shall be governed by and construed in accordance with the laws of the Republic of South Africa.*

(b) *Subject to the provisions of Clause [x] (Fast-track Dispute Resolution), each Party agrees that the High Court of South Africa shall have exclusive jurisdiction to hear and decide any application, action, suit, proceeding or dispute in connection with this PPP Agreement, and irrevocably submits to the jurisdiction of the High Court of South Africa.*

88 AMENDMENTS[568]

This will be a relatively standard provision.

Standard Clause

Amendments

No provision of this PPP Agreement (including, without limitation, the provisions of this Clause) may be amended, substituted or otherwise varied, and no provision may be added to or incorporated in this PPP Agreement, except (in any such case) by an agreement in writing signed by the duly authorised representatives of the Parties.

89 WAIVER

This will be a relatively standard provision.

Standard Clause

Waiver

(a) *Any relaxation, indulgence or delay (together "**Indulgence**") by either Party in exercising, or any failure by either Party to exercise, any right under this PPP Agreement shall not be construed as a waiver of that right and shall not affect the ability of that Party subsequently to exercise that right or to pursue any remedy, nor shall any Indulgence constitute a waiver of any other right (whether against that Party or any other person).*

568 Amendments to a PPP Agreement may only be executed by the accounting officer or accounting authority, as the case may be, of the relevant Institution (see Treasury Regulation 16.9), and must comply also with Chapter 8 of the PFMA. Further, any material amendment will require the approval of the relevant Treasury.

(b) *The waiver of any right under this PPP Agreement shall be binding on the waiving Party only to the extent that the waiver has been reduced to writing and signed by the duly authorized representative(s) of the waiving Party.*

90 ENTIRE PPP AGREEMENT

This will be a relatively standard provision.

Standard Clause

Entire PPP Agreement

(a) *Except where expressly provided otherwise in this PPP Agreement, this PPP Agreement constitutes the entire agreement between the Parties in connection with its subject matter and supersedes all prior representations, communications, negotiations and understandings concerning the subject matter of this PPP Agreement.*[569]

(b) *Each of the Parties acknowledges that:*

(i) *it does not enter into this PPP Agreement on the basis of and does not rely, and has not relied, upon any statement or representation (whether negligent or innocent) or warranty or other provision (in any case whether oral, written, express or implied) made or agreed to by any person (whether a Party to this PPP Agreement or not) except those expressly contained in or referred to in this PPP Agreement, and the only remedy available in respect of any misrepresentation or untrue statement made to it shall be a remedy available under this PPP Agreement; and*

(ii) *this Clause shall not apply to any statement, representation or warranty made fraudulently, or to any provision of this PPP Agreement which was induced by fraud, for which the remedies available shall be all those available under the law governing this PPP Agreement.*

91 CONFLICTS WITH OTHER CONTRACTS

91.1 Each project will require several contracts in addition to the PPP Agreement and the Direct Agreement, for example, a Construction Subcontract, an Operations Subcontract and several second-tier subcontracts.[570]

91.2 The parties to these contracts will not all be the same. Thus the Institution is only likely to be a party to the PPP Agreement and the Direct Agreement. The

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[569] The undertakings of the Private Party in the PPP Agreement should, to the extent that they are different from those in its bid proposal, be an "improvement" on the bid proposal for the Institution in terms of value for money, affordability and risk transfer. Accordingly, from a "procurement" point of view, the reliance on the PPP Agreement as reflecting the true agreement between the Parties is appropriate. Further, the PPP Agreement, if properly drafted, should reflect all matters raised in the RFP and all commitments made by the Private Party in its bid proposal (save as improved on in the negotiations).

[570] See also Part B:4 (*Project Documents and Project Deliverables: Project Documents*).

Private Party will be a party to some but not all of the contracts, for example, it will not be a party to the second-tier subcontracts. The PPP Agreement must identify all the contracts required for the Private Party to perform the Project Deliverables (these are referred to herein as the "**Project Documents**"). The PPP Agreement must also include a simple provision setting out the priority in which the various Project Documents will rank if there is any conflict between provisions in them. The PPP Agreement is the primary contract and should prevail over other contracts in respect of the Project.

Standard Clause

Conflicts with other contracts

In the event of any conflict between this PPP Agreement and any Project Document, the provisions of this PPP Agreement will prevail. In the event of any conflict between any of the Project Documents, the following order of precedence will apply, with agreements listed earlier in this list prevailing over those listed later:

[Insert the ranking of the Project Documents]

92 SEVERABILITY

It is customary in South Africa for contracts to include a clause providing that if there are provisions in the contract which become invalid, illegal or unenforceable, they can be excluded from the contract, while the rest of the contract continues to stand. It should be understood that, while these clauses do no harm, they are no guarantee that the intentions expressed in them will apply. South African courts have repeatedly ruled that the basic approach for contracts with provisions which become invalid, illegal or unenforceable is that the courts should decide on a case-by-case basis how these provisions affect the remaining provisions of the relevant contract. The courts are not bound by what the parties have agreed.

Standard Clause

Severability

Whenever possible, each provision of this PPP Agreement shall be interpreted in a manner which makes it effective and valid under applicable law, but if any provision of this PPP Agreement is held to be illegal, invalid or unenforceable under applicable law, that illegality, invalidity or unenforceability shall not affect the other provisions of this PPP Agreement, all of which shall remain in full force.

93 COUNTERPARTS

Wherever possible, both Parties to the PPP Agreement should sign the same document at the same time and in the same place. However, if this is not possible, then each Party may sign separate identical copies of the PPP Agreement, either in different places at the same time, or even at different times and places. These separate copies are commonly referred to as "counterparts".

Standard Clause

<u>*Counterparts*</u>

This PPP Agreement may be executed in any number of identical counterparts, all of which when taken together shall constitute one agreement. Any single counterpart or a set of counterparts taken together which, in either case, are executed by the Parties shall constitute a full original of this PPP Agreement for all purposes.

94 NOTICES AND LEGAL SERVICE

94.1 The PPP Agreement should include a clause which sets out the addresses chosen by the Parties where notices and other communications (including, without limitation, any approval, consent, demand, query or request) contemplated in the PPP Agreement may be sent or delivered. The Clause should allow for different ways of giving those notices, for example, by registered post, hand delivery, facsimile or e-mail.

94.2 The Clause should set out the procedure to be followed if a Party wishes to change its chosen address.

94.3 If there is a dispute between parties to a contract resulting in them becoming involved in litigation, then they will have to deliver various legal documents to each other. Some of these must be delivered by an official of the Court. The formal term for delivery of all of these documents is "service". South African law allows for these legal documents to be served at an address chosen by the relevant party in the contract even if that party is not present at that address or has left that address. This is intended to assist parties who might otherwise have had great difficulty in actually locating the party with whom they are in dispute. Because of the rules relating to service, it is prescribed that any address for service must be a physical address in South Africa.

Standard Clause

<u>Notices and Legal Service</u>

(a) All notices and any other communications whatsoever (including, without limitation, any approval, consent, demand, query or request) by either Party in terms of this PPP Agreement or relating to it shall be given in writing and sent by registered post, or delivered by hand, or transmitted by facsimile or electronic mail to the recipient Party at its relevant address set out below:

(i) if to the [Institution], at:

Address:

Postal address:

Facsimile number:

Electronic mail address:

[marked for the attention of ……………….]

(ii) if to the Private Party, at:

Address:

Postal address:

Facsimile number:

Electronic mail address:

[marked for the attention of ……………….]

(b) Either Party may, by written notice to the other Party, change any of the addresses at which or the designated person for whose attention those notices or other communications are to be given.

(c) Any notice or other communication given by any Party to the other Party which:

(i) is sent by registered post to the addressee at its specified address shall be rebuttably presumed to have been received by the addressee on the [7th (seventh)] day after the date of posting; or

(ii) is delivered by hand to the addressee during the normal business hours of the addressee at its specified address shall be rebuttably presumed to have been received by the addressee at the time of delivery; or

(iii) is transmitted by facsimile to the addressee during the normal business hours of the addressee at its specified facsimile number shall be rebuttably presumed to have been received by the addressee on the date of transmission as indicated on the sender's facsimile transmission report; or

(iv) is transmitted by electronic mail to the addressee during the normal business hours of the addressee at its specified electronic mail address shall be rebuttably presumed to have been received by the addressee on the date of transmission as reflected on the sender's electronic mail records.

(d) The previous provisions of this Clause shall not invalidate any notice or other communication actually given and received otherwise than as described in those provisions.

(e) The Parties choose their respective physical addresses in Clause (a) as their respective domicilia citandi et executandi at which all documents relating to any legal proceedings to which they are a party may be served. If that address is changed to another address which is not a physical address in the Republic of South Africa, then the original address shall remain the domicilium citandi et executandi of the relevant Party until it nominates a new physical address within the Republic of South Africa in writing to be its new domicilium citandi et executandi.

95 CONFIDENTIALITY

95.1 The prescribed approach is that as much information in the PPP Agreement or as provided in terms of it as possible be placed in the public domain and only information which is commercially sensitive or sensitive for public interest reasons should be protected and excluded.

95.2 The Parties may wish to protect the confidentiality of that sensitive information provided by either of them to the other or set out in the PPP Agreement. Two important points should be kept in mind:

95.2.1 under the Promotion of Access to Information Act, 2000 both the Institution, as a public body, and the Private Party, as a private body, are obliged to make available a great deal of information which they hold to any person who asks for it. That Act does allow some information, including commercially sensitive information, to be protected and not disclosed. Although the Parties may want to include a Clause in the PPP Agreement obliging each of them to respect and protect the confidentiality of the information provided by the other Party, that provision cannot prevail over the obligations of the respective Parties under the Promotion of Access to Information Act; and

95.2.2 not all information provided by one Party to the other is confidential and as such the Parties should not try to extend confidentiality protections to information which does not warrant these protections. The Parties should therefore define what constitutes confidential information in a realistic and objective way. The test for whether information should be protected as confidential should be whether the disclosure would cause real prejudice to the interests (legal and/or commercial) of the relevant Party.

95.3 Neither Party should be penalised if confidential information is disclosed to any third party in any way that is not its fault or that does not constitute a breach by it of its obligations.

95.4 Securities exchanges and some other regulatory bodies have publicity requirements that must be complied with by entities of which they are in charge. These types of disclosure requirements should be taken into account in agreeing upon the confidentiality obligations in the PPP Agreement, and should not be prohibited or restricted to an extent that prevents the relevant Party from complying with its obligations to the relevant securities exchange or other regulator.

Standard Clause

<u>Confidentiality</u>

*(a) For purposes of this Clause, "**Confidential Information**" means any information which is agreed by the Parties at the time of conclusion of this PPP Agreement or before it is provided to the recipient Party to be [commercially sensitive] [sensitive on grounds of …….].*

(b) Each Party shall keep all Confidential Information of the other Party confidential while this PPP Agreement remains in force [and for a period of [x] years after it terminates for any reason]. Each Party shall also use reasonable endeavours to prevent its employees, agents and Subcontractors from making any disclosure to any person of any Confidential Information of the other Party while this PPP Agreement remains in force [and for a period of [x] years after it terminates for any reason].

(c) Clause (b) shall not apply to:

(i) any disclosure of information that is reasonably required by persons engaged in the performance of the restricted Party's obligations under this PPP Agreement;

(ii) any matter which a Party can reasonably demonstrate is already generally available and in the public domain otherwise than as a result of a breach of this Clause;

(iii) any disclosure as part of any attempt to resolve a dispute in accordance with Clause [x] (Dispute Resolution) or Clause [x] (Fast-track Dispute Resolution);

(iv) any disclosure which is required by any law (including any order of a Court of competent jurisdiction), or the rules of any stock exchange or governmental or regulatory authority having the force of law;

(v) any disclosure of information that is already lawfully in the possession of the receiving Party prior its disclosure by the disclosing Party;

(vi) any provision of information to the advisors of the receiving Party, or to any funders or potential funders, but in the latter case, only to the extent reasonably necessary to enable a decision to be taken on whether that potential funder will become a funder;

(vii) any disclosure by the Institution of information relating to the design, construction, operation and maintenance of the Project and any other information that may be reasonably required for the purpose of retendering of this PPP Agreement in accordance with Clause [x];[571] *or*

(viii) any disclosure of information by the Institution to any Responsible Authority.

(d) The disclosures permitted under Clauses (c) (vi), (vii) or (viii) may only be made subject to obtaining appropriate confidentiality restrictions consistent with the provisions of this Clause from the intended recipients.

96 SIGNATURE FOR INSTITUTIONS

96.1 Institutions must bear in mind the requirements of Treasury Regulation 16.2.1 which restricts authority to sign PPP Agreements on behalf of Institutions to their Accounting Officers or Accounting Authorities, as the case may be.

96.2 In addition, where a PPP Agreement falls within the provisions of chapter 8 of the PFMA, additional authorisations required by that chapter may mean that the PPP Agreement must also be signed by the applicable National or Provincial government official as provided therein.

[571] This is the Clause dealing with retendering in Part N:65 (*Termination: Compensation on Termination for Private Party Default*).