

# The APMG Public-Private Partnership (PPP) Certification Guide



The APMG PPP Guide, referred to here as the PPP Guide, is the Book of Knowledge (BoK) detailing all relevant aspects of creating and implementing efficient, sustainable public-private partnerships (PPPs). It is intended for use by PPP professionals, governments, advisors, investors, and others with an interest in PPPs. The PPP Guide is part of the family of CP<sup>3</sup>P credentials that, once obtained, allow individuals to use the title “Certified PPP Professional,” a designation created under the auspices of the APMG PPP Certification Program. The APMG PPP Certification Program, referred to here as the Certification Program, is an innovation of the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank through its Multilateral Investment Fund (IADB through its MIF), the Islamic Development Bank (IsDB) and the World Bank Group (WBG) funded by the Public-Private Infrastructure Advisory Facility (PPIAF).

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## Chapter 6: Tendering and Awarding the Contract

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## **Introduction**

This phase covers the period from the launching of the project to the point of financial close. This chapter assumes that the government has chosen to tender the project, rather than negotiating directly with a potential private sector contractor. The benefits of choosing a tender process are discussed in chapter 1.

During the Structuring Phase, explained in chapter 5, the tender process has been designed, including qualification criteria, evaluation criteria, and the requirements for submission of both qualifications and proposals.

As explained in chapter 5, in relation to the tender process, the tender package will also include regulations on timing (deadlines for the submission of qualifications and proposals, the time limits for asking for clarifications, and the expected timing of any dialogue phase), as well as other regulations related to any dialogue or interactive types of processes.

Regardless of the level of detail in the Request for Proposal (RFP), the tender process must be managed proactively to drive value through competition and ensure that obstacles and threats do not jeopardize the process. In a dialogue or interactive process, the procuring authority will face special challenges in managing the dialogue or interaction in order to preserve confidentiality while maintaining transparency and fairness in the process. Specific information will be provided in this chapter on this issue.

As there are a range of distinct tender processes (see appendix to chapter 4), this chapter sets out the main milestones and activities that are present in all processes to be handled by the procuring authority through the selection and awarding of the contract. It also includes specific information on dialogue and interactive processes<sup>1</sup>.

In addition, despite the fact that this PPP Guide is structured around the vision and needs of the procuring authority, the special appendix included in this chapter will present the views of the future private partner. This describes how the private sector partner needs to organize and manage the tasks of bid preparation and submission, as well as executing the contract and raising the finance to commence the works.

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<sup>1</sup> For the sake of simplicity, the explanation of the process will not include the fact that in some processes the proposal may be staged. This involves submitting at least two proposals, the initial and the final offer.

### **BOX 6.1: Learning Objectives**

Readers will be able to:

- Understand the mechanics of the approvals/authorizations necessary through to financial close
- Manage any potential need for changes or re-scheduling in the procurement process
- Handle the qualification and evaluation processes
- Understand the need for any conditions prior to contract signature
- Understand the distinction between commercial close and financial close, and the key elements of the financial close process.

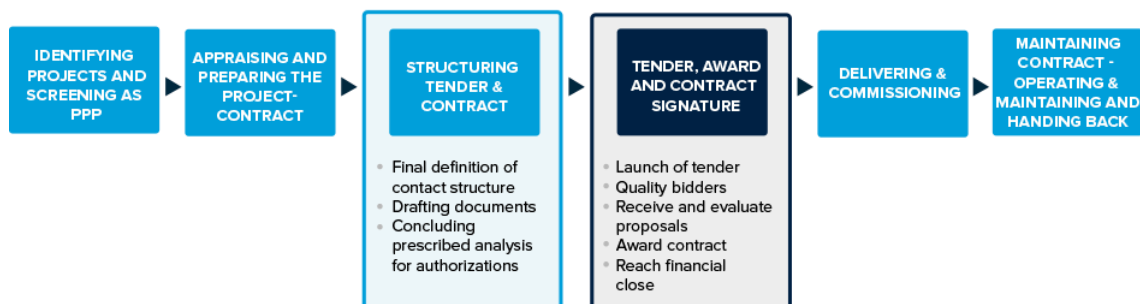
## **1. Where We are in the Project Cycle**

During the previous phase, the contract structure was developed (with particular attention to financial and risk elements), the tender package was drafted, and authorization was sought to launch the tender process. See figure 6.1.

This phase covers the period from the launch of the project (which may be through a Request for Qualifications (RFQ) stage or by directly issuing an RFP in some jurisdictions), through the process of qualifying bidders, receiving and evaluating proposals, to the contract award and financial close stage.

At the end of this phase, the procurement process ends and the Contract Management Phase begins (contract management is discussed in chapters 7 and 8).

**FIGURE 6.1: Where We are in the Process Cycle**



## **2. Objectives of this Phase**

The objectives of this phase are as follows:

- To conduct a smooth procurement process and avoid interruptions and re-scheduling;
- To deliver a contract that will demonstrate Value for Money (VfM) and will benefit both parties;
- To secure a prompt, rapid, and effective approval for signature;
- To handle the selection process in an effective manner, ensuring transparency;
- To ensure that, at the time the PPP contract is executed, the government will have a high degree of certainty that the winning bidder will secure the required financing and deliver the required outcomes according to schedule; and
- To effectively utilize competition to deliver the optimal Value for Money outcome for the government.

To meet these objectives, the procuring authority must:

- **Design the RFP appropriately:** The procuring authority's ability to manage the tender process as smoothly as possible, and maximize value through competition, will depend on the regulation of the tender process (time, requirements of the offers, qualification/selection criteria, and evaluation criteria), that is, the design of the RFP (as explained in chapter 5);
- **Apply general principles of good procurement:** Many features and characteristics of the PPP tender process are the same as in any public procurement process. The same general principles of good procurement will apply for a PPP procurement (transparency, fairness, and so on). Transparency in tendering is the essence of a fair and competitive process. The tender process should meet international standards for transparency and provide a level playing field for bidders;
- **Recognize the complexities of PPPs:** While general principles of good procurement apply to PPPs, PPPs also have special characteristics that must be considered in the conduct of the tender and awarding processes. These special characteristics are set out in section 3;
- **Recognize the specific characteristics of the project:** Each project will have unique requirements. These requirements must be addressed both in the structuring and drafting of the tender package (discussed in chapter 5), and in the conduct of the tender and awarding processes (discussed in sections 4 to 13); and
- **Follow the applicable laws and policy requirements governing procurement in the relevant jurisdiction:** The PPP tender process must be adapted to the applicable laws and policy requirements governing procurement in the relevant jurisdiction. These laws and policy

requirements are affected by a wide range of factors, including the overall legal system and the past historical experience that the government has had of contracting with the private sector. Consequently, there is significant variation in the tender process from one country to another. Nevertheless, the underlying principles and objectives of the process are much the same everywhere. In some cases, the general laws and policy requirements governing procurement will not be well suited to the specific needs of PPP projects, as outlined in section 3. Therefore, if the objectives set out are to be realized (see chapter 2 for a discussion of the establishment of an appropriate PPP framework), the government will need to put in place specific requirements for PPPs, rather than relying on general laws and policy requirements.

### **3. Special Characteristics of the PPP Tender Process**

Most of the features and characteristics of the tender process will be the same as in any public procurement process, but some stages and steps have specific characteristics and features. Special considerations inherent to the particular complexities of PPPs are listed below.

- **Time to prepare and submit offers:** This will usually be longer than in a conventional procurement. Due to the intricacies of the PPP processes (including complexities faced by the private partner), it is essential to grant the bidders sufficient time for proper due diligence, analysis, and assessment of the project and the contract from different fronts. This is discussed in section 5;
- **Interaction with the market/bidders:** As explained in previous chapters, an initial interaction/communication process should be carried out before the tender launch occurs. However, some interaction should also take place during the tender process to better inform bidders about the project, and to clarify potential inconsistencies or amend unintended errors in the wording of the RFP and the contract (see section 6). In some countries, more extensive interaction occurs (this is discussed in section 8). A balance needs to be found so as not to endanger the legality of the process and potentially suffer a challenge that may paralyze the process or require the government to re-issue the tender;
- **Risks of challenges to the process:** Due to the incremental complexity of the contract and process, the risk of a challenge is considered higher in PPPs than in a conventional procurement. In addition to the possibility of a challenge by an unsuccessful bidder, in some countries it may be possible under administrative law for the wider public and civil organizations to challenge the process if their interests conflict with the nature and objectives of the PPP. There may also be non-legal routes to

challenge the process (for example, by applying political pressure). Some bidders may be willing to force a project cancellation because they may not be ready enough to participate (which links to the first concern expressed above about allowing sufficient time to bid). The risk may be exacerbated in countries in which both the public and private sectors lack PPP experience. As such, there are no shared expectations as to how the process will unfold. Management of challenges to the process are discussed in section 11;

- **Time for evaluation:** Evaluating PPP bids is a more complex matter than evaluating conventional contracts. PPP evaluation requires a knowledge of both the PPP's technical and financial features, including the particularities of the technical proposal and how it interacts with the financial sustainability of the offer.

The room for potential non-compliance with the proposal requirements is significantly larger than in a conventional procurement.

Linked with the higher risk of challenges is also a need to be accurate and stick with the rules and methodology for bid evaluation (and selection/qualification) as described in the RFP (section 9. discusses the practicalities of evaluation management); and

- **Contract signature or commercial close<sup>2</sup>. Prior conditions:** In a PPP, management of the contract signature process is more demanding for both the public and private parties. A longer period is required to allow the private partner, as awardee, to prepare for signature, especially (in some jurisdictions) the need to form a special purpose vehicle (SPV) that will sign the contract.

There are usually some other prior requirements for contract signature, such as contracting (or booking) insurance and providing definitive bonds or guarantees (in lieu of the bid bond). In some cases, the financial model must be audited prior to contract signature, while in other cases this may be delayed until financial close (for those contracts that allow for arranging finance after the contract signature). Section 11 explains these issues further.

Taking into consideration those special features of a PPP tender process, the box 6.2 proposes a list of conditions to be met or areas of specific care when preparing and conducting a tender process.

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<sup>2</sup> "Commercial close" is another term for contract signature.



#### ***BOX 6.2: Conditions for a Successful Tender Process***

- The project should have a clear strategic direction and strong political support.
- The procuring authority should establish a sufficiently resourced and capable team that will be credible in the eyes of bidders.
- Good planning and program management practices should be implemented throughout the process.
- The RFP, including submission requirements, should be carefully drafted (see chapter 4) and should be consistent and clear.
- Appropriate relevant information should be provided to bidders through pre-bid conferences and a data room (in addition to the RFP).
- The evaluation criteria should be as objective and clear as possible.
- The evaluation criteria should not be changed during the process.
- The qualification and evaluation work should be organized in advance (including an internal manual for evaluation).
- The formal evaluation process should be conducted by an appropriate expert team and managed properly (for example, decisions by the procurement board should be clearly recorded with reasons given).
- Strong capabilities and resources should be available to manage last minute interactions and potential challenges, as well as for evaluation and qualification.
- The time for bid submission should be realistic.
- A realistic timeline should be set for award and contract signature (including time for evaluation and award and for preparation for signature).

## **4. Overview of the Phase**

Generally, there are four main stages into which any tender process may be divided.

- Pre-qualification (in open tenders with a pre-qualification stage) or short listing (in a process with a short listing or pre-selection of candidates);
- Bid period – from launching through bid submission or reception (in open tenders without pre-qualification) or from invitation to offer (or to negotiate) through bid submission in other processes;

- Bid evaluation (including qualifications in a one-stage open tender) and award — the procuring agency receives, analyzes/assesses, evaluates, and selects a winner (usually named the preferred bidder)<sup>3</sup>; and
- Contract signature (from decision to award to the signing of the contract) — financial close may occur at the end of this period or at a later time after contract signature.

The actual outline of the process and a more detailed description of the phases will vary depending on the tender process type (see appendix A to chapter 4).

At one extreme of the spectrum of tender process types is the one-stage open tender: the RFP is issued together with the RFQ. Here the qualification criteria are published in the same package of documents, and at the same time as the evaluation criteria and the requirements to propose, together with the proposed PPP contract. Submission of qualifications is concurrent with the submission of the proposals.

In this process, the stages or periods may be described as follows.

- Tender advertising and issuance;
- Bid preparation (from RFP launch to proposal submission);
- Evaluation of qualifications and proposals (from bid submission/reception to award);
- Contract signature (from award to signing of the contract); and
- Financial close.

The main variation of the open tender process is the two-stage open tender with pre-qualification. This is where the pass/fail test of qualifications is done in a previous stage and the RFP is issued, or candidates are invited to propose, only after the qualification process has finished. Figure 6.2 illustrates the one- and two-stage open tender processes.

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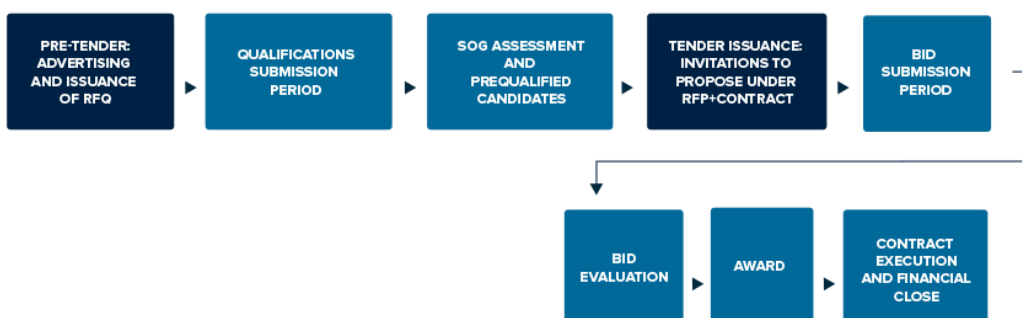
<sup>3</sup> Negotiation is a variation that may be present in any of these processes, and several proposals are sometimes considered before a final proposal is requested in some processes.

**FIGURE 6.2: Open Tender: One- and Two-Stage Processes**

**Open tender – one stage**



**Open tender – two stages ( prequalification )**



Note: RFQ= Request for Qualification; SoQ=Submission of Qualification.

At the other extreme of the spectrum of variations, there are various interaction or dialogue processes. Any interactive process is very different to the standard open tender process structure. The RFP is discussed or clarified through interaction during the bid preparation stage, or there may even be dialogue to define the contract solution through the dialogue stage (competitive dialogue in the European Union [EU]). This type of process has the following stages or sub-periods.

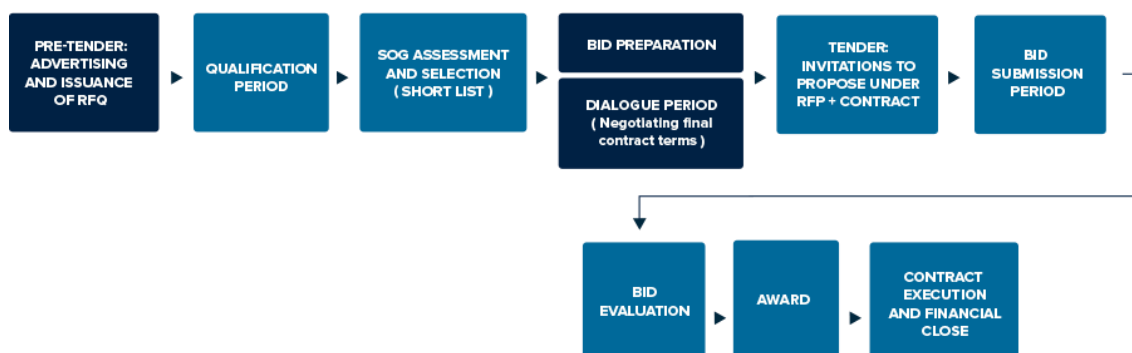
- Qualification preparation (up to submission of qualifications);
- Evaluation of qualifications and selection of short-listed candidates;
- Dialogue/interactions, bid preparation, and bid submission: from invitation to engage in dialogue (or to engage in an interactive processes) to proposal submission;
- Evaluation of proposals (from bid submission to award decision); and
- Contract signature (from award to signing of the contract).

Dialogue and interactive processes work best in mature PPP markets and may be difficult to implement in some developing countries.

Figure 6.3 illustrates the competitive dialogue type of process used in the EU. The main difference between this and the highly interactive process used in Australia and New Zealand is that in the former, the RFP and the contract may evolve progressively through the dialogue process, whereas in the latter the interaction focuses less on changing the RFP or the contract, and more on enabling bidders to progressively develop their bids, receiving feedback from the government as they do so.

**FIGURE 6.3: Dialogue or Interactive Process: EU Competitive Dialogue**

Dialogue or interactive process - EU Competitive Dialogue



Note: RFQ= Request for Qualification; SoQ=Submission of Qualification.

The main difference in terms of management and process between open tender types of process and those involving a dialogue or structured interaction resides in the dialogue or interaction phase. The other challenges of the tender in terms of process and management are the same as in other procurement methods. In this context, in all of them the authority will have to qualify and evaluate offers to select the awardee and subsequently manage the contract signature process.

The subsequent contents of this chapter introduce issues regarding the management of the bidding stage (sections 5 to 7), and specifically the interactions in dialogue or interactive processes (section 8).

The rest of the chapter then explains the main actions to be undertaken by the authority to handle the key milestones that are common for any tender type: the process of evaluating and selecting the awardee, including negotiating with a preferred bidder if the PPP framework allows for this (sections 9 to 11), and taking the project through to a successful execution of the contract (section 12), and financial close (section 13).

## **5. Time to Prepare and Submit Offers: Requirements for Proper Assessment and Preparation by the Prospective Bidders**

As introduced in section 2 of chapter 5, it is essential to give the bidders sufficient time to prepare a sound and high quality offer. Especially in open tender models, one of the common pitfalls in a PPP procurement is that the procuring authority allows bidders insufficient time for this work.

This project failure may take different forms. It may result in there being no bids because bidders did not have time to prepare a reliable offer in sufficient detail to be acceptable to their board(s). It may be due to the submission of hurried, poor quality bids that will be disqualified — or worse still, it may result in the submission (and selection/awarding) of an inadequate offer by a bidder that

assumes it will have the ability to re-negotiate what is initially considered as an unfeasible project.

It is good practice for the framework to establish a minimum time for bid submissions, which in most jurisdictions is at least 30 days. However, even the specified minimum time may not be sufficient, depending on the complexity of the project (in technical, financial, and even legal terms) and the degree of advance preparation required. Therefore, a decision must be made on a project-by-project basis as to whether a longer period is required than the minimum specified in the framework.

When defining the period/time limit for bid submissions, it is essential to grant to the bidders sufficient time for a proper analysis and assessment of the project and the contract from several different fronts.

- The technical bid and construction contract will be delivered in a more risky context than a traditional procurement. The “contractor” (here the private partner) is assuming more significant risks regarding construction (both in terms of costs and time). These will need to be meaningfully assessed and managed by transferring them (or most of them) to the sub-contractor (even if the construction contractor belongs to the very same company group as the investor and prospective bidder);
- Financial or commercial feasibility is a particular dimension of the practicality of a PPP route. It requires bidders to assess the feasibility of the project in overall terms. The revenues projected in a user-pays project or in a government-pays project must be sufficient to cover all costs and recover investments. Bidders must also test whether the bid will be bankable (the risk perception of the bank or lender may not necessarily be the same as that of the bidder). The capital costs estimated by the bidder (including debt and equity in terms of minimum target economic internal rate of return [eIRR]) may not be in accord with the original assumptions made by the government when the project was initially appraised and structured. A bidder’s perception of risk and its value (in terms of risks premiums) may also differ;
- Assuming that the project as structured, including any government payments or support, is commercially feasible from a bidder’s perspective (that is, there is some room for competition in terms of price), the bidder needs time to optimize its cost structure: negotiating with suppliers/contractors and refining the financial structure to optimize capital costs;
- Usually the bid is submitted by a group of companies using a joint venture or consortium approach. This requires complex agreements (shareholder agreements) that demand time for negotiation and implementation in advance of the offer;
- Bidders will usually require approval from their boards. Time must also be allowed for this approval process;

- When the government requires bidders to develop the financial package in advance of the bid submission, additional time is needed to allow for the lender's due diligence and approval processes; and
- Finally, the proposal itself, in terms of documenting a response that meets the government's submission requirements, needs significantly more time than in a conventional procurement (see chapter 5.8.1).

At the same time, it may also be dangerous to allow too extensive a time period for bid preparation. A PPP bid is more demanding than a conventional procurement in terms of resources (internally dedicated, plus advisers), and time is in essence a matter of costs. Looking for the right balance is therefore a tricky issue, which is often solved within a range of 30–90 days for open tender processes, although in many projects 90–120 days may be preferable to ensure good quality responses (see table 6.1 below).

Also, a common mistake is to initially rely on unrealistically short periods for submission, while planning to correct the situation later by providing an extension. Extensions should generally be the exception to the rule because changes to the time table are perceived as a lack of reliability and may adversely affect the PPP reputation of the procuring agency. However, it is better to give an extension if the alternative is project failure because no bids are received.

This is less of an issue in dialogue processes where dialogue occurs before the procuring authority issues the final RFP because the time allowed for dialogue is designed to allow the prospective bidders to assess the project and prepare their offers.

In some two-stage processes, where the government requires bidders to submit comprehensive proposals (for example, extensive designs and committed finance), a longer period between the issuing of the RFP and the receipt of bids is appropriate. For example, in Australia this period is typically in the realm of 150 days.

Table 6.1 sets out examples of the actual bidding periods (including extensions) for a variety of projects in a number of countries.

<i>TABLE 6.1: Examples of Bidding Periods in Different Countries</i>					
Country	Project	Sector	Tender Process	Bidding Period (number of days)	
Brazil	Abastecimento de Água Potável e	Water/wastewater	Single-stage open tender	33	

	Esgotamento Sanitário (Sumaré)			
Philippines	Cavite-Laguna Expressway	Road	Single-stage tender open	70
Brazil	Hospital da Zona Norte (Amazonas)	Health	Single-stage tender open	106
Australia	Ravenhall Prison Project	Prison	Two-stage tender with short listing and interactive tender process	147
South Africa	Gautrain Rapid Rail Link	Rail	Two-stage tender with short listing and interactive tender process	180

## 6. Managing Matters during the Bid Submission Stage in Open Tenders

The following section applies to any open tender process, including those with a previous pre-qualification phase. In processes with such a pre-qualification phase, the RFP is only issued when the qualification process has been concluded.

### 6.1. Launching the Tender Process<sup>4</sup>

Launching is the milestone that triggers the tender process. Tender documents are published through standard government processes, often in the official government bulletin or journal, on a centralized procurement website, or in regional or national newspapers.

Sometimes, in the case of procurement by sub-national governments, a tender notice is also published in the central government bulletin. In the EU member states, a public tender also needs to be made public in the *EU Official Journal* (OJEU).

In some countries, prospective bidders must register or pay a fee in order to receive the RFP.

In some jurisdictions (for example, the EU), the tender must be pre-announced a certain number of days in advance of when the actual tender process starts and the RFP is published. That pre-announcement is intended to ensure that as many companies as possible are aware of the project. It describes the main characteristics of the project and the tender: tender method, type of contract, the contract value<sup>5</sup>, and so on.

These standard government processes are often contained in general procurement rules. However, this will not necessarily ensure that the project comes to the attention of the full field of potential bidders.

Regardless of the specific process required to formally launch the tender process, the procuring authority should implement a pre-launch strategy that ensures potential bidders are aware of the project, as well as the planned timing of the tender process. This enables bidders to ready themselves for the launch and properly resource their bidding teams. When the procuring authority has not conducted a structured testing and marketing process during

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<sup>4</sup> Under a two-stage open tender process, the initial invitation is only for the submission of qualifications which are assessed to confirm the list of candidates that will be invited to tender.

<sup>5</sup> Contract value is usually the volume of capital expenditures (Capex) estimated by the procuring authority, or sometimes refers to the total amount of payments to be made by the procuring authority if the bid equals the ceiling on payments.



the Structuring Phase (see chapter 5.6.), it would be necessary for the procuring authority to conduct at least a pre-bid information meeting or presentation prior to the release of the invitation to tender, sharing information in relation to the tender process and the project.

Box 6.3 sets out some of the communication channels that may be included as part of a prelaunch of the PPP project.

***BOX 6.3: Targeting Potential Bidders as Part of the Prelaunch***

The procuring authority should ensure that it targets potential bidders that are likely to be interested in the project and capable of delivering it. A range of communication paths may be considered, including:

- Publishing information on the internet.
- Advertising in the regional, national, and international press.
- Advertising in trade publications.
- Press releases.
- Road shows.
- Providing information through embassies.
- Providing information through industry associations.

## **6.2. Bid Stage**

The bid stage occurs with the issue of an invitation to tender to the deadline for bid submission.

This stage is, by definition, a private sector stage. During this time, prospective bidders assess the project and the proposed contract, and prepare their bids (appendix 6A explains the bid preparation process from the perspective of a bidder).

However, the procurement team must manage the following tasks during this phase.

- The procurement team and the procuring authority will usually do preparatory work for the evaluation phase by defining evaluation teams and governance. If following best practice, this includes the preparation of an evaluation manual;
- If the evaluation team does not have past experience in this form of evaluation, it is good practice to conduct a training session for

evaluators to ensure a consistent understanding of how the evaluation is to be conducted;

- There may be a bidder conference after the issue of the invitation to tender, at which the procuring authority presents key features of the project to potential bidders. Bidders may also be given the opportunity to make site visits during this time. These activities must be carefully managed by the procurement team to ensure transparency and fairness of the process;
- The procurement team will need to manage any data room through which information is made available to bidders (see chapter 5 for a discussion of the use of data rooms); and
- Questions and requests for clarification will be received during this period until the deadline for question submission is reached. The deadline is necessary so that the procuring authority has time to issue proper responses and clarifications.

### **6.3. Clarifications of the Contract and RFP**

It is good practice for the procuring authority to allow requests for clarification of the contract and the RFP, but the procuring authority should retain discretion about whether to respond. The procuring authority should provide a response wherever this will assist bidders to provide a better bid and not undermine the RFP process.

A clarification in the true sense does not amount to a material change in the RFP or the draft contract; it merely removes ambiguity or uncertainty in the mind of bidders as to the meaning of those documents. Clarifications are important to ensure that bidders correctly interpret the government's requirements.

Responses should be made available to all potential bidders and will usually be regarded as part of the RFP package (good practice). However, they will not prevail over the original text of the RFP unless the original text is specifically amended<sup>6</sup>.

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<sup>6</sup> Note that in some two-stage processes, if allowed by the procurement rules, it may be appropriate to only provide a response to the bidder who asked the question, as the question and response may relate specifically to that bidder's proposal and may be irrelevant to other bidders. Where this option is allowed, great care must be taken in its application to ensure that a response provided to only one bidder does not give that bidder an unfair advantage.

## **6.4. Assessing Potential Changes to the Contract and RFP**

As a result of questions asked by bidders through the clarification process, it may become apparent that the procuring authority needs to materially change aspects of the contract, tender requirements, or criteria.

Conducting a proper appraisal and structuring/drafting process, through meaningful assessment and preparation, is the best route to avoid this risk.

However, if the procuring authority faces a situation in which prospective bidders request changes in order to make the project commercially feasible, the authority will have to decide whether such changes are really needed to avoid receiving no bids, or whether that risk is worth taking.

If requests for change are considered reasonable and the change is affordable for the procuring authority, that change will usually require an extension to the bidding period (unless the change occurs early in the bidding period). It is good practice to provide such an extension. However, it may be necessary (depending on the legal framework of the respective jurisdiction) to cancel the process and re-issue the tender. This depends on an assessment (in legal terms) of whether the clarification or the change is substantial.

Another option, if allowed under the relevant framework, is to release the RFP and provide bidders with an opportunity to comment, then re-issue the RFP and require bidders to accept the reissued version before releasing the data room and draft transaction documents. Formal acceptance of the RFP can protect the procuring authority against subsequent objections from losing bidders. This approach can be beneficial if the project is novel or complex, and the procuring authority sees value in obtaining very specific feedback on the project structure. In this process, bidders are likely to provide more carefully considered and detailed feedback than in an earlier market sounding process.

Similar issues arise if the procuring authority identifies that additional data that was not originally in the data room should be provided to bidders. The procuring authority must manage the risks associated with late release of such information. An extension of the bidding period may be appropriate to allow all bidders to fully consider the additional information and adjust their bids accordingly.

## **6.5. Being Responsive**

The procuring agency should be responsive to the requests for clarifications, providing appropriate answers in due time to give prospective bidders the best opportunity to provide high quality bids.

## **6.6. Open Meetings**

During the bid submission period, it is good practice to have interim open meetings with prospective bidders to present responses to the questions and facilitate the provision of any information relevant to the process (for example, if a government is retaining the responsibility for land expropriation, progress on this should be reported). Such meetings are usually held with all bidders collectively, although in some processes there may be separate meetings with each individual bidder. See section 8 for further information on the conduct of such meetings.

## **6.7. Asking for Extensions**

It is common for bidders to formally or informally ask for extensions to the bid submission deadline, claiming a lack of time to prepare the bids.

When one or more bidders request an extension, others might be ready to submit; therefore, an extension may produce an unfair disadvantage to those bidders who are prepared to submit on time. However, if an extension is not given, there may not be enough competition. The procuring authority should assess the situation and find a balanced response, taking into account any other external factors that may have delayed the bidders (such as extended public holidays).

In addition, an extension to the submission period may, like any other material change, be perceived by the market as a sign of volatility and lack of commitment by the government.

The best practice in terms of dealing with time issues is, as stated before, the setting of a realistic deadline based on a properly prepared project.

## **7. Qualification Matters**

In a one-stage process with open tender, qualifications are presented at the same time as the offer. The procuring authority must first assess qualifications before evaluating the bids. Separating these two steps sequentially is generally regarded as good practice, and some jurisdictions regulate the process in this way through their legal framework to protect transparency.

In a two-stage open tender (pre-qualification), or in interactive or dialogue processes, qualification is done in advance of inviting the candidates to prepare and submit the bid (or to participate in a dialogue or interaction).

In two-stage processes, an issue can arise if there is a change in the composition of a bidding consortium between pre-qualification and the submission of bids. The RFQ should specify whether this is allowed, in what circumstances, and what consequences may follow. Some flexibility in consortium membership can be desirable to enable a pre-qualified consortium to bring in additional organizations that can strengthen its bid. However, a consortium should not be allowed to continue in the process if its composition changes such that it would no longer be capable of meeting the pre-qualification requirements. The procuring authority should minimize the likelihood of changes in consortium membership by ensuring that there is not an unduly long period of time between pre-qualification and bidding.

Otherwise, the considerations regarding proper management of the pre-qualification process are the same in one- and two-stage tenders. In some two-stage processes, there is an added task of evaluating the qualifications in order to select a short list of candidates.

The main considerations relating to a proper qualification process (and also applicable to the evaluation process) are as follows.

- The essence of the assessment procedure is the RFP (or RFQ, if using a two-stage process);
- Qualifications must be assessed in accordance with the criteria announced and described in the RFP (or in the RFQ in a two-stage process). Deviations from the criteria and methodology laid out in the RFP are not consistent with the transparency needed and will likely result in challenges to the outcome (see chapter 4 for a description of typical qualification criteria);
- The team whose task it is to assess the qualifications must be sufficiently skilled in the respective areas involved; and
- A manual or a set of established procedures used to assess the qualifications is important to further document the process and methods that are to be applied. This is especially the case, for consistency purposes, when more than one person will assess any particular criteria or sub-criteria. However, any manual that is developed should remain consistent with all the criteria described in the RFP (or the RFQ).

## **8. Specific Matters on Managing Dialogue and Interactive Processes: Managing the Dialogue Period and One-on-One Meetings**

In addition to the need to select or pre-select the candidates in a short list (see chapter 5.6.4), the competitive dialogue processes (and other interactive processes) have a number of particular and common issues.

These relate to the special stage of interaction or dialogue where the technical requirements and commercial drivers of the contract are discussed or even proposed by the prospective bidders (the latter being the case with competitive dialogue in the EU).

- The interaction process itself (meetings, information to be submitted beforehand, feedback from the candidates, and so on) has to be managed well in terms of time;
- Confidentiality has to be managed concurrently with fairness of the process and transparency;
- In competitive dialogue, changes to the basic specifications and/or the basic business terms have to be respected. However, these must clearly be identifiable as improvements; and
- Due to the small number of short-listed bidders, specific situations such as a bidder withdrawing from the tender process are critical in these type of processes.

These and other matters are treated in detail in the main guides available internationally. While most of them are tailor-made for specific markets, many of the issues described and the solutions proposed are useful for any process in any country which contemplates this type of process within their legal or policy PPP framework<sup>7</sup>. A decision to use competitive dialogue or another highly interactive process should only be made after carefully assessing whether the procuring authority has the capability and capacity to effectively manage such a complex and intensive process.

Detailed below is some basic information on managing meetings with individual bidders, which are a key feature of this type of process<sup>8</sup>.

## 8.1. Managing the Risk of Meetings with Individual Bidders

Having separate meetings with each potential bidding organization or consortium can provide better outcomes than only having a single meeting

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<sup>7</sup> Australia's National PPP Guidelines (2011), *Volume 2: Practitioners' Guide*, appendix E provides extensive information on management issues in interactive tender processes. The joint United Kingdom's (UK's) Office of Government Commerce/HM Treasury *Guidance on Competitive Dialogue* (2008) also provides information on key issues during the dialogue stage in its section 5.3.

<sup>8</sup> *How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets*, PPIAF, World Bank – Farquharson, Torres de Mästle, and Yescombe, with Encinas (2011) includes an interesting case study that explains the process followed in the tender of a hospital in South Africa (see page 126). The tender process was based on a two-stage process with significant interaction and dialogue (including one-on-one meetings) with the short-listed consortia before bid submission. The case study illustrates, among other things, how sound governance of the tender process is essential, including a structured evaluation process leveraging separate evaluation teams and internal and external scrutiny that ensured a high level of transparency.

attended by competing organizations. However, meetings with individual bidders also entail a range of risks. The better outcomes arise because meetings with individual bidders enable greater depth of discussion, and potential bidders may be less willing to discuss their concerns or issues in front of competitors but be more willing to do so in a meeting where competitors are not present.

The risks of conducting such meetings include the greater demand on the time and resources of the government team, and the potential (either in reality or as matter of perception) for one bidder to be given information not provided to other bidders, thus compromising the fairness of the process. As a matter of good practice, a number of measures are used to mitigate this risk.

- Rules for conduct of the meetings are circulated to all participants in advance;
- If the meeting occurs prior to the release of the RFP, a project information memorandum is circulated to all participants in advance, and additional information is not given during the meetings;
- The government uses a pre-prepared script during the meetings to ensure that, as far as possible, the same questions are answered in the same way in each meeting;
- At least two government representatives attend each meeting (more than two may be appropriate to minimize the risk of allegations of impropriety);
- The process is well documented through records of attendance and minutes of the meetings;
- In some projects, the questions and answers are circulated to all bidders in de-identified form, without disclosing any information specific to an individual bidder; and
- In some projects, an independent party is appointed to attend the meetings and to provide confirmation that no bidder was given an unfair advantage over other bidders.

Even if meetings with individual bidders are held, it is often also beneficial to conduct a forum or presentation at which all bidders are present. This provides an efficient forum in which the government can convey key messages in relation to the project.

## **9. Evaluation of Proposals**

As with assessment of qualifications, proposals must be evaluated in accordance with the criteria set out in the RFP. In this sense, there will be an important difference in terms of process between price-only evaluation and a combination of quality and price criteria. The latter is clearly more complex, and the discussion below focuses on this approach.



The information contained in this section is applicable to any process type, including dialogue and interaction processes.

As noted in section 3, evaluating PPP bids is a more complex matter than evaluating conventional contracts, and the risks of non-compliant bids and of challenges to the process are accentuated in PPPs. The main corrective factors for these risks are having clear rules for evaluation and robust evaluation decision-making processes. It is paramount to engage highly capable and experienced resources to carry these out.

It is also good practice to set up a practical guide or evaluation manual for the project to ensure consistency among different reviewers/evaluators, including that they understand any potentially unclear or ambiguous terms in the evaluation criteria.

A clear audit trail of all of the evaluation steps, discussions, and decisions should be maintained.

## **9.1. Administrative or Compliance Check**

The first step in evaluation is a review of formal requirements, which is also called the ‘administrative requirements’ of the proposal. This involves confirming that the bid was submitted as required by the RFP, checking that powers and signatures are valid, and confirming that the bid complies with a number of general legal requirements. These may include checking that there are no unresolved issues with the tax authorities or that there are no impending prosecutions for corruption or a fraudulent act. The absence of any such issues means that an organization is sometimes referred to as being in “good standing”. These checks must be carried out before the evaluation (in strict terms) of the proposal is made.

In two-stage processes, these reviews will be part of the pre-qualification process and will then be re-checked at the RFP stage.

While the initial compliance check will identify obvious issues (such as missing signatures or missing parts of the bid), more subtle non-compliance issues might only be identified during the evaluation itself (for example, a technical proposal that omits some requirements, or an alternative bid where these were excluded). The RFP and the evaluation manual should document the process for dealing with such issues.

When there are errors that may be regarded as “remediable”, it is customary to give the bidder an opportunity to correct them. This should always be limited to immaterial errors and not basic elements of the proposal. If the bids are made public under transparency principles, any errors and the corrections should also be made public.



## 9.2. Evaluation Committees

Where the assessment has significant subjective/qualitative elements, it is important to have that evaluation performed by subject matter experts.

In some cases, the subject matter experts may be government employees, in other cases they may be external advisers/consultants.

For example, according to EU legislation, when subjective/qualitative assessment represents more than the 50 percent of the total weight of evaluation criteria, the authority must constitute an expert committee including the presence of independent experts.

If the evaluation is conducted by external advisers/consultants, it is good practice to structure the process so that the decision to recommend a bidder to the awarding authority is a decision made by government employees on the advice of the external advisers/consultants.

## 9.3. Price and Quality Evaluation Process

As explained in chapter 5, the most common type of evaluation process is based on a combination of criteria.

In this context, as introduced in chapter 5, there are two approaches, which may be regarded as good practice: a streamed process and a consecutive or staged approach. Factors relevant to the choice between these approaches are discussed in box 6.4.

When the evaluation process does not allow complete separation of technical/qualitative criteria from financial/numerical criteria, it is paramount (and considered good practice) for transparency purposes to carry out the evaluation in a structured streamed process<sup>9</sup>. In this sense, apart from the administrative conformity/compliance, the evaluation work should be divided into the following concurrent streams (in terms of process management).

- Evaluation of the technical offer and other potential valuation drivers subject to qualitative assessment; and
- Evaluation of the economic/price offer and potentially other numerical criteria.

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<sup>9</sup> Further reading on evaluation matters may be found in Infrastructure Australia (2011) *National Public Private Partnership Guidelines*. A discussion on the bid evaluation process can be found in these guidelines in section 12 of the Volume 2 (Practitioners' Guide).

In many jurisdictions, rather than streams, these sub-processes of evaluation will be done consecutively in separate stages. In some cases, this is a legal requirement (prescribed by law, for example, in EU legislation) with the authority obliged to seal the completed technical or qualitative evaluation before opening the financial/economic offer envelope. In many countries, this process occurs in a public venue.

There are different techniques to organize and perform the qualitative evaluation work and to ensure that processes and criteria are applied consistently across bids. For example, having each individual consistently evaluating the same sub-criteria across all bids, having each evaluator assessing one bid under all sub-criteria but then discussing with other specialists the results to ensure consistency, or having multiple evaluators jointly assessing bids against sub-criteria through a consensus process<sup>10</sup>.

If the rules of the tender process allow bidders to submit alternative offers along with their primary bid, the evaluation process must identify how each bid (the base bid and the alternative bid) will be treated — for example, by evaluating each of these as separate bids, providing the base bid has met all of the administrative and compliance requirements and the alternative bid has met any requirements set out in the RFP for such bids.

In some projects, the evaluation criteria are such that the evaluation can be enhanced by developing a performance model to aggregate and systematically and objectively assess input data from bidders. However, this requires an up-front investment in development of the performance model, validation that the model correctly links the inputs to the evaluation criteria, and transparency in the process. In some (but not all) cases, the evaluation criteria will be such that the performance model can be developed from the financial model for the project.

Most of the potential approaches to evaluation are valid as long as they respect transparency and fairness, and in this sense they will ensure consistency in the interpretation of the evaluation criteria and sub-criteria. For this reason, as noted, it is good practice to develop a manual for evaluation.

It is important to keep the different elements of the evaluation separated by physical and informational barriers, that is, those involved in the technical evaluation should not have access to details of the financial evaluation and vice versa. This ensures that evaluators' perceptions are not influenced by aspects of the bid that are not relevant to the specific criteria they are evaluating.

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<sup>10</sup> As introduced in chapter 4, it is not uncommon and may be considered good practice to establish a floor for technical scoring so that no offer with less than x points in technical evaluation (or y points as minimum in some specific sub-criteria) will be qualified. Rather, it will be rejected (and the price or economic offer will also be rejected).

Regarding the financial offer, the evaluation panel will have to consider the consistency and responsiveness of each of the offers (some processes require certain documents to be in the financial envelope rather than in the technical envelope<sup>11</sup>). Analysis of the financial offers can be complex, and it is good practice for the evaluation panel to obtain detailed independent analysis of the financial offers by finance specialists. Time should be allowed for this. The evaluation panel (or the awarding authority) may even reject some offers because they are potentially considered in “temerity<sup>12</sup>”, that is, underbidding too aggressively, or for other reasons described in chapter 5. In some processes the financial offer will be subject not only to quantitative/numerical evaluation, but to some qualitative assessment as well.

Only after this check and definition for responsive offers will it be possible to announce the awardee under the final scoring calculation.

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<sup>11</sup> For instance, the requirement to submit a financial offer with the bid under reasonable terms for the commitment and availability of finance.

<sup>12</sup> “Temerity” refers to an offer made on terms that might be considered reckless, in the hope of winning the project and subsequently being able to negotiate a more favorable outcome. In some jurisdictions (for example, in Spain), it is customary to establish a threshold of temerity in relative terms. For example, any offer that is below the average bid by more than 15 percent will be considered too aggressive for the purpose of evaluation. According to Spanish legislation, the authority may give the bidder the opportunity to explain and argue the rationale of that offer, and additional security may be required by the authority to ensure the availability of funds.

***BOX 6.4: Staged versus Streamed Evaluation. When is a Streamed Evaluation Appropriate?***

Many countries conduct a staged evaluation process, as described in the main text, sequentially performing the technical/qualitative evaluation and then the financial/economic evaluation. This is a well-tested approach and may be particularly appropriate if the government is seeking an acceptable technical solution at a good price, and there are significant concerns about corruption or undue influence in the process.

However, some countries (generally more developed countries with significant PPP experience) have processes in which bidders can offer different (innovative) solutions. These may require amendments to the contract that will be specific to each bidder, or they may create different risk or cost exposures for the government. In such cases, a separate decision cannot be made on price, but there must be a parallel or “streamed” technical/qualitative and financial/economic evaluation because there may need to be discussion between the technical and financial evaluation teams to ensure the implications of the innovative solutions are properly understood by each team and the evaluation is conducted on a consistent basis.

For example, it would be inappropriate for the technical evaluation team to score a proposal on the assumption that the government will accept an offer of a higher level of service from that bidder, but for the financial evaluation team to assess the price on the basis that the government will only pay for the base level of service assumed in the RFP. In this evaluation process, the evaluation teams may talk to one another about elements of the bidders’ proposals. However, they should respect the strict separation of the actual evaluation against the evaluation criteria — that is, a team evaluating one of the criteria should not discuss its evaluation of bids against that criteria with another team not involved in evaluating that criteria.

## **10. Negotiation with a “Preferred” Bidder**

A major difference between procurement approaches in different countries is in the extent to which the government enters into negotiations with the “preferred” (but not yet successful) bidder following the evaluation process, but prior to the award of the contract.

The need for post-bid negotiation can arise for a range of reasons, including those listed below.

- The RFP requirements or draft contract may not have been clear, but this may not have been identified during the RFP clarification process. This may arise if a bidder thinks the RFP is clear but they have interpreted it differently from government's intention;
- The RFP requirements or draft contract may not have been acceptable to bidders and their lenders (in particular, with respect to the proposed risk allocation);
- The wording in the draft contract may have assumed that bidders would meet the RFP requirements in a particular way, but the preferred bidder may have chosen a different solution that nevertheless meets the RFP requirements. For example, the RFP may allow the equity to be invested in the form of share capital or subordinated debt, but the contract may have been drafted on the assumption that the equity only consists of share capital. Therefore, some negotiation may be required to ensure relevant clauses in the contract appropriately apply to subordinated debt; and
- The bidder's proposal may have been sufficiently clear for the purposes of the evaluation, but some details that were not material to the evaluation may be unclear or poorly worded, and the government may wish to negotiate clearer, more precise wording.

In each of these situations, negotiation can enable the parties to reach a mutually agreeable position. It also reduces the risk of issues arising later in the life of the project due to a lack of clarity in the documentation or a lack of consistency between the bidder's proposal and the contract. However, negotiating at any stage can be challenging, and negotiation creates a risk of reducing the transparency of the bid process.

The challenge can be even greater once a preferred bidder has been identified, as the preferred bidder will consider itself to be in a strong position in the negotiations, even if a reserve bidder is maintained as a fallback option. For this reason, care should be taken during the structuring of the tender and the contract to ensure that the documents are clear and the risk allocation will be acceptable to bidders – see chapter 5.

If negotiations are required, and are allowed under the applicable framework, the negotiation process must be carefully managed to ensure that legitimate issues are resolved without the preferred bidder gaining a better position at the expense of the government.

Due to the risks associated with negotiation, some governments do not allow negotiation of the terms of the contract at any stage of the process (although room for negotiation on bidders' proposals may remain).

Once any negotiations have been completed, it is good practice to require the preferred bidder to resubmit its proposal, amended to reflect the negotiations. It is also good practice for the government to assess whether the proposal, as

updated, retains Value for Money, and whether it remains appropriate to award the contract to the preferred bidder.

## **11. Award**

After the tender is evaluated according to the relevant criteria provided in the RFP and any negotiations are satisfactorily completed, the award decision is made by the relevant authority, usually based on the recommendation made by the evaluation team.

In some countries/jurisdictions, this does not imply a definitive selection because endorsement of the decision may be required at a higher level (for example, by the cabinet). Alternatively, bidders may challenge the evaluation decision within a certain time limit, which is known as a “standstill period” (see box 6.5). A standstill period, with challenges prohibited after that period expires, can be beneficial to ensure that any challenges to the process are made promptly and not strategically deferred by the losing bidders.

If any necessary endorsement has been received and there are no appeals, the award decision will become definitive and, in some countries, will be published in the respective official journal (although this is not a universal practice). After official or definitive awarding, the winning bidder (awardee) will be called for the contract signing.

In some jurisdictions (but uncommonly), it may be necessary at this point to obtain the authorization or validation of a general attorney and/or of a general auditor, or it may even be necessary to obtain a ratification by the legislature.

If there is a delay in the awarding process beyond the timelines provided in the RFP, the procuring authority should consider whether the winning bidder will still be capable of meeting the contractual milestones and the commitments made in its bid. It may be necessary to agree to revised dates as a result of the delay — although if the changes are substantial, this may provide a basis for other bidders to challenge the award decision. The best means to mitigate this risk is to establish realistic timelines for the award process from the outset, and to ensure that decision-makers understand the risks associated with delays.

### **11.1. Challenging an Award Decision**

As noted in section 3, the risk of a challenge to the tender or award process is considered higher in PPPs than in a conventional procurement. To mitigate this risk, the procuring authority must have sound preparation and procurement processes, and a legal team and relevant subject matter experts

prepared to handle potential challenges — including the ability to resolve disputes in the interests of moving the process forward.

Challenges may come after tender launch, or after award of the contract. In the latter case, they will usually be based on potential deviations from the evaluation and selection rules set out in the RFP.

If there is a legal challenge to an award decision, the procuring authority must engage legal resources and relevant subject matter experts to respond to the challenge and defend the award decision. A typical process for such challenges is that a judge will analyze the challenge and may decide to reject it. Alternatively, the judge may temporarily suspend the awarding process so as to analyze and judge the matter more carefully. Or the judge may declare the award decision invalid, which may result in an award to the second ranked bidder. In a worst case scenario, it can even lead to a suspension of the process with the need to re-tender the project contract, depending of the country's normal practice.

#### ***BOX 6.5: 'Standstill Period' in EU Legislation***

As the European PPP Expertise Centre (EPEC) PPP Guide describes<sup>13</sup>, according to the EU legislation, “a minimum 'standstill period' of 10 days is required between the PPP contract award decision and the actual conclusion of the contract to allow rejected bidders time to conduct their review and decide whether they want to challenge the award”.

“An aggrieved bidder can bring an action to have the PPP contract rendered ineffective if the authority contravened EU procurement rules in a serious manner. Previously, the sole remedy that an aggrieved bidder could seek was to be awarded monetary compensation, but nowadays an aggrieved bidder could seek cancellation of the PPP contract. How the various rights and obligations of the parties will be determined in this case is left to national law.”

## **11.2. The Issue of No or Only One Responsive Proponent**

It is possible that no bidders will submit, which constitutes a clear process failure. This is best avoided by having a well-planned and well-structured tender process, consistent with the practices described in chapter 5 of this PPP Guide. If it does eventuate that there are no bidders, it is not uncommon to grant additional time for bid submissions when there is evidence that time

<sup>13</sup> See *How to Prepare, Procure and Deliver PPP Projects* (EPEC 2012). <http://www.eib.org/epec/g2g/iii-procurement/31/314/index.htm>



insufficiency was the cause of the failure. Otherwise, the process will be suspended, and it might be re-tendered after adjusting the structure or requirements — if there is evidence that the lack of responses can be remedied without compromising the VfM.

A variation of this situation is when there are proposals but all of them are regarded as irresponsible (typically due to a lack of financial or commercial feasibility – this can be related to an insufficiently high price ceiling or possibly other factors related to risk). In such cases, it is not uncommon for the authority to open a negotiation process with the best proposer, while a redefinition of the project (subject to a reassessment or re-appraisal) may be more appropriate.

It is also possible that only one bidder submits (or more than one bidder submits, but only one meets both the qualification requirements and the requirements of a valid bid). This can place the procuring authority in a difficult position. If the project was unattractive to all other potential bidders, this may reflect a poorly structured project that is unlikely to succeed. The sole bidder may also be overly ambitious and have an unrealistic expectation that it can deliver the project.

The procuring authority is in a weak bargaining position if it chooses to engage in direct negotiation with the sole bidder, as there is no alternative bidder to turn to if a satisfactory outcome cannot be agreed. Some governments prevent this situation arising by requiring that there be a minimum of two valid bids in order for the procuring authority to award the contract. Other jurisdictions seek to protect the government's position by limiting which aspects of the bid can be subject to negotiations. For example, the Philippines' PPP Implementing Rules and Regulations allow direct negotiation with a sole bidder, but only with respect to the proponent's financial proposal and its rate of return. Hence, the sole bidder cannot try to negotiate a change in the risk allocation. Nevertheless, negotiating with a sole bidder on this basis may not provide a good outcome (for example, because the sole bidder has met the requirements necessary to have submitted a valid bid, but the bid may offer very poor Value for Money). It is therefore good practice for the procuring authority to reserve the right to terminate the tender process if only one valid bid is received, and to re-tender the project or seek an alternative solution in these circumstances.<sup>14</sup>

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<sup>14</sup> For further information on sole bidder situations, see *Competitive Dialogue in 2008*. OGC/HMT Joint Guidance on Using the Procedure (UK Office of Gov. Commerce, 2008) – BOX 5.7. "Market failure and single bidder situations".



## **12. Contract Signature**

Once the contract has been awarded, the necessary steps are taken to proceed to the signing of the contract by both parties.

Upon award, the successful bidder (called the 'preferred bidder' in some markets) will be required to sign the contract within the period prescribed in the RFP.

### **12.1. Prior Conditions**

Before the deadline expires, the successful bidder will have to meet certain prior conditions as established in the RFP. The following conditions are typically included.

- Establishment of a Special Purpose Vehicle (SPV) that will be the concessionaire;
- Contracting of insurance policies (or in some cases, proving that insurance is available under the terms required by the RFP and contract) and providing any performance guarantees required in favor of the authority; and
- Financial close: In some jurisdictions, financial close (that is, the execution of the financial agreements) is a prior condition in the sense that it is simultaneous to the commercial close (contract signature). Alternatively, contract signing does not occur until all other preconditions to financial close have been satisfied – this matter is explained in the section 13 below.

Once the prior conditions are fulfilled, the PPP contract will be signed with the SPV, and the successful bidder will officially become a contractor.

If the winning bidder is not able to fulfill all of the conditions before the deadline or refuses to sign the contract, the public authority may apply liquidated damages and/or make a call against the bid bond (when a bond or guarantee was required with the bid submission). If that occurs, the authority will usually call the next ranked bidder to sign the contract or may decide to re-issue the tender.

### **12.2. Clarification versus Changes**

During the course of this period, it is common for both the authority and private partner (still as preferred bidder or successful proposer) agree on certain minor changes in the contract to resolve mistakes or clarify ambiguities. It may also be necessary to incorporate specific features of the

winning bidder's proposal into the contract according to some practices (while in others, the offer is directly considered a part of the contract).

However, in most of the jurisdictions, any material change that would potentially result in another bidder bidding differently (if they knew of the change), is forbidden. This is good practice in terms of PPP strategy and framework. In these cases, the border between a clarification and a change may be subtle and such changes requested by the preferred bidder should be carefully assessed by the procuring authority before it decides whether to agree to them — even at the risk of the contract not being signed and a need for re-tendering.

### **12.3. Will the Contract be made Public?**

Chapter 2.9.3 of the PPP Guide explains the importance and significant benefits of transparency and proactive disclosure in PPP programs. It also provides examples of disclosure policies that are considered to be good practice. In some jurisdictions, it is compulsory to publicly release the contract as-signed.

If the contract is made public, it is good practice to redact any genuinely proprietary or commercially sensitive information where disclosure may disadvantage the winning bidder by making this information available to competitors. Failing to redact such information may deter companies from bidding. In addition, in some projects (such as those in the defense or prison sectors) the government may need to exempt some contractual material from disclosure for public interest reasons.

### **12.4. Debriefing of Bidders**

It is good practice for the procuring authority to debrief both the successful and unsuccessful bidders after the contract has been executed. In each case, the debriefing should not focus on the relative merits of the bids. Rather, it should be directed at providing each bidder with general information on how it can better meet the government's expectations in future projects.

## **13. The Financial Close**

Financial close is a stage with a high degree of variation in market practice among jurisdictions. Financial close means not only that the financing documents have been signed, but also that the prior conditions for the availability of financing have been fulfilled.

As described in chapter 5, in some jurisdictions (for example, in Spain), the contract provides a limited time (which might be as little as six months or as much as eighteen months) after contract signing in which the private partner must arrange finance and execute the financial agreements. In some other jurisdictions and processes (typically negotiated or dialogue processes), bidders have already arranged the finance prior to contract award, and financial close occurs soon after commercial close (the process can take anywhere from a few hours to several weeks, depending on the circumstances). Chapter 1.7.3 contains a discussion about these two different approaches.

Table 6.2 provides example projects of the actual time periods that elapsed between contract signing and financial close in various countries.

**TABLE 6.2: Examples of time periods between contract signature and financial close**

Project	Government	Contract Signing	Financial Close	Time Period (Days)
Ravenhall Prison Project	Victoria, Australia	15 September 2014	16 September 2014	1
Development of Fourth Container Terminal at Jawaharlal Nehru Port	Maharashtra, India	6 May 2014	2 November 2014	180
Mactan-Cebu International Airport Passenger Terminal Building	Philippines	22 April 2014	22 December 2014	244

No matter when financial close occurs, that milestone will have implications for the authority. In all cases, the authority will have to validate the financial agreements to check that they do not contravene the provisions of the contracts or represent any direct risk or additional responsibility not considered in the contract. It is common for the authority (especial in emerging markets) to acknowledge the contract and specifically validate the lender's rights as agreed and described in the contract (for example, the lender's rights to step-in and cure defaults).

The authority may also make direct contractual representations to the lenders (through direct agreements or direct letters). These are not necessarily direct

guarantees in favor of the lenders<sup>15</sup>, but nevertheless these representations give the lenders comfort that they will be able to exercise their rights in respect of the project should the need arise.

During this period, there is a degree of alignment between the authority and the private partner. It is generally in both parties' interests to promptly achieve financial close so that this finance is available for the project to proceed.

Another typical issue that may have implications for the authority during the financial close period is the use of the base interest rate risk-sharing mechanisms (see chapter Appendix to chapter 5). In some projects, the procuring authority will bear part or all of the risk that base interest rates change in the period before financial close.

## **14. Oversight / Integrity of the Tender Process**

Some governments provide for independent oversight of the tender process while it is occurring to ensure that it is fair and transparent.

For example, governments in Australia and New Zealand appoint a probity practitioner to ensure that a transparent and robust process is followed at all times. The probity practitioner is independent of the project team and is responsible for monitoring the bidding process and for assessing and reporting on whether the process has been conducted to the required standards.

Probity practitioners typically have legal or accounting backgrounds, and they are appointed on a project-by-project basis. They are able to receive any complaints or concerns raised by bidders during the process so that the issue can be dealt with at that time rather than exposing the project to a challenge later when an award is made. They attend all of the critical stages of the evaluation process, such as the opening of the bids and the meetings of the evaluation committee, and at the conclusion of the evaluation they confirm that it has taken place in accordance with the applicable requirements. The Philippines is introducing a similar process for large projects.

In many countries, auditors-general also have a role, conducting ex-post audit reviews of the conduct of PPP tender processes.

A further measure to protect the integrity of the tender process is to place the onus on bidders to avoid corrupt practices and to ensure that, if a bidder

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<sup>15</sup> Direct guarantees in favor of lenders may also be established in the contract; this may be the case in both emerging economies and developed economies, or it may be that the government is a financial partner of the Special Purpose Company (SPC). Both situations make clear the need for and relevance of proper management processes, and have direct implications of the financial close for the authority.

engages in corrupt practices, the terms of the tender process allow the procuring authority to take remedial action such as:

- Cancelling the bidder's appointment as preferred bidder or contractor;
- Calling any bid bond; and
- Suing for damages to recover from the bidder the costs of the procuring agency as a result of the corrupt conduct, including the costs of re-running the procurement process if necessary.

## **15. Outcomes of this Phase**

At the end of this phase, the authority has in place an enforceable and effective contract, duly executed after the accomplishment of prior conditions.

In some processes, financing has been arranged within this phase (as a prior condition to contract signature), while in other processes it will be arranged before construction commences. This can be either because of a condition embedded in the contract or as a practical consideration, since the standard approach by any investor will be to only commence work after financial close.

It is good practice for the procuring authority to conduct a "lessons learned" review of the tender process to identify examples of good practice and areas for improvement in future projects. Where relevant, the lessons learned should be shared with any central PPP agency and with other procuring agencies of the same government that are undertaking PPPs. In some instances, it may be beneficial to also make a subset of the lessons available to the public to better inform bidders for future projects.

The end of this phase represents the start of the life of the contract and the concurrent "contract management" period. Therefore, although the tender and award phase may have come to an end, the public-private partnership is only just beginning.

As explained in the next chapter, a contract management strategy must be established at contract signature. It is usual for the preparatory work and the establishment of the contract management framework to be done in parallel with contract signature and even during the bid preparation stage.

Throughout the contract management period (either during the Construction Phase or the Operations Phase), the contract may be affected by risk events, potential disputes, and potential changes in the scope of the contract or in the service requirements.

## References

Name of Document	Authors/Editors and Year	Description	http link (when available)
<b>Key References for PPP Tender Processes</b>			
<b>Infrastructure Australia National PPP Guidelines Volume 2: Practitioners' Guide</b>	Commonwealth of Australia (2011).	Includes guidelines on PPP tender processes, and the management of interactive tender processes.	<a href="http://infrastructureaustralia.gov.au/policy-publications/public-private-partnerships/files/Vol_2_Practitioners_Guide_Mar_2011.pdf">http://infrastructureaustralia.gov.au/policy-publications/public-private-partnerships/files/Vol_2_Practitioners_Guide_Mar_2011.pdf</a>
<b>Online Toolkit for Public Private Partnerships in Roads and Highways World Bank</b>	PPIAF (2009).	Includes a description of PPP tender processes.	<a href="http://www.ppiaf.org/sites/ppiaf.org/files/documents/toolkits/highwaystoolkit/index.html">http://www.ppiaf.org/sites/ppiaf.org/files/documents/toolkits/highwaystoolkit/index.html</a>
<b>World Bank Reference Guide Volume 2</b>	World Bank (2013).	Includes a good summary of the key issues related to PPP tender processes.	<a href="http://ppp.worldbank.org/public-private-partnership/library/public-private-partnerships-reference-guide-version-20">http://ppp.worldbank.org/public-private-partnership/library/public-private-partnerships-reference-guide-version-20</a>
<b>The Guide to Guidance - How to Prepare, Procure and Deliver PPP Projects</b>	European PPP Expertise Centre (EPEC) (2012).	Includes an overview of the key steps in the bidding process, finalization of the PPP contract, and financial close.	<a href="http://www.eib.org/epec/g2g/iii-procurement/31/314/index.htm">http://www.eib.org/epec/g2g/iii-procurement/31/314/index.htm</a>
<b>Public-Private Partnership Handbook</b>	Asian Development Bank (2008).	Includes an overview of the key activities related to PPP tender processes.	<a href="http://adb.org/sites/default/files/pub/2008/Public-Private-Partnership.pdf">http://adb.org/sites/default/files/pub/2008/Public-Private-Partnership.pdf</a>
<b>Other References and Readings cited in this Chapter</b>			
<b>Competitive Dialogue in 2008. OGC/HMT Joint Guidance on Using the Procedure</b>	UK Office of Gov. Commerce (2008).	Describes the process and key issues to consider when conducting a competitive dialogue as regulated by the European Union (EU).	<a href="http://webarchive.nationalarchives.gov.uk/20110601212617/http://ogc.gov.uk/documents/OGC_HMT_2008_Guidance_on_Competitive_Dialogue.pdf">http://webarchive.nationalarchives.gov.uk/20110601212617/http://ogc.gov.uk/documents/OGC_HMT_2008_Guidance_on_Competitive_Dialogue.pdf</a>
<b>Disclosure of Project and Contract Information in Public Private Partnerships</b>	World Bank Institute (2013).	A review of practices regarding the disclosure of information on PPP projects and contracts.	<a href="http://wbi.worldbank.org/wbi/document/disclosure-project-and-contract-information-public-private-">http://wbi.worldbank.org/wbi/document/disclosure-project-and-contract-information-public-private-</a>

			partnerships
<b>How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets</b>	PPIAF, World Bank - Farquharson, Torres de Mästle, and Yescombe, with Encinas (2011).	Includes an interesting case study that describes an example of a tender process, which illustrates a number of the features discussed in this chapter.	<a href="https://openknowledge.worldbank.org/bitstream/handle/10986/2262/594610PUB0ID1710Box358282B01PUBLIC1.pdf?sequence=1">https://openknowledge.worldbank.org/bitstream/handle/10986/2262/594610PUB0ID1710Box358282B01PUBLIC1.pdf?sequence=1</a>
<b>FIDIC Procurement Procedures Guide</b>	International federation of consulting Engineers (FIDIC, 2011).	A general guide to the procurement of engineering and building works projects of all sizes and complexities (not specific to PPPs).	<a href="http://fidic.org/sites/default/files/procurement-promo-doc05-3.pdf">http://fidic.org/sites/default/files/procurement-promo-doc05-3.pdf</a>

## **Appendix A to Chapter 6: Bid Preparation and Submittal – The Private Sector Perspective**



## 6.1 Introduction and Purpose

This section describes the approach taken by the private party in a PPP project. The private party is the private sector entity that is successful in securing the right to implement and operate the procuring authority's PPP project. A variety of names may be used to describe this private party. These terms include the private partner, the consortium and the Special Purpose Vehicle (SPV). Such terms are interchangeable and this section uses all of them.

In this section, it is assumed that the private party is responding to a greenfield PPP project that is being procured by a public authority under a one-stage, single tender process, all as outlined in the previous chapter. It is assumed too that during the bidding stages of the procurement, the private party will put in place indicative funding arrangements and that these will be finalized, with the provision of fully committed funding, at the financial close of the PPP project.

It should be noted that the activities carried out by the private party, described in this section, may be the same if the procurement is for a brownfield PPP project, or if the project is a privatization or secondary market transaction. On a related note, many of the activities may also be carried out as part of certain non-PPP procurements (see chapter 1), such as Design-Build-Operate (DBO), or Design-Build-Finance-Operate-Manage (DBFOM) management contracts and concession/lease arrangements. However, consideration of these types of procurements, and the specific activities required of the private party to implement them, is outside the scope of this PPP Guide.

In this section, an account is given of the various stages of the private party's PPP pathway, highlighting some of the key activities that it will carry out at each stage.

This section describes the factors that influence the private party's decision to invest in a particular country and, specifically, to respond to the procuring authority's Request for Proposal (RFP). It sets out how the private party puts its PPP project tender response together. This is a process that includes forming a bidding consortium and appointing advisors, right through to developing its commercial strategy and detailed technical, financial and legal solutions for the PPP project.

PPP projects involve the planning, design, construction, and provision of a PPP project asset together with the provision of associated services, such as the operation and maintenance of that asset. They also require a significant

amount of financial support. Achieving this requires a series of agreements to be completed.

It is not simply the project agreement that needs to be entered into with a procuring authority; the private party will also need to enter into a suite of agreements with its construction, operation, and maintenance contractors, as well as the funders who will be providing financial support. A description of the required set of agreements is explained in this section. The key issues that have to be addressed by the private party, before entering into these agreements, are also highlighted.

Attention is also focused on the type of finance the private party can obtain for the PPP project, the lending requirements that must be met, and the stage at which fully committed funding is provided.

A description of the private party's role at the concluding stages of the PPP project's procurement, commercial close, and financial close is provided. Additionally, a note of the key activities that the private party needs to carry out in order to form the SPV is included in this section.

An overview of this section and its key learning points is set out below.

### ***Targeting and Selecting Markets and Projects***

The decision to select a PPP project depends on the region/country, the sector/market, and the project itself. The PPP project must be evaluated in commercial, financial, and risk terms once the RFP has been released (PPP project screening).

If the PPP project screening is sound, the private party will decide to participate in the bid. Resources should be spent only when the decision to participate in the bid is positive.

### ***Putting a Bidding Consortium Together***

A bidding consortium includes four key private partners: sponsor(s), construction contractor(s), operations and maintenance contractor(s), and the lender(s) to the consortium. Sponsors must look for potential/like-minded partners in order to develop a winning bidding team.

The selection of bidding partners should be based on common goals, common cultural values, practical experience, and value (not price).

The consortium will be structured and operate in accordance with contractual arrangements such as the Letter of Intent, the confidentiality agreement, the Memorandum of Understanding (MoU), and the Consortium Agreement (CA). The parties involved in the consortium will agree to the work each party needs to carry out in order to prepare and submit the consortium's bid. The cost of carrying out such work will be agreed and shared between the consortium's members.

The Consortium Agreement will anticipate the basic terms of the future project and project company governance, including the decision-making process.

Project governance over the Tender Phase is assumed by the steering committee and is supplemented by the sponsors and the bid manager.

The steering committee decision-making mechanisms must be designed to resolve disputes and conflicts of interests among partners.

### ***Getting Advisors on Board***

One of the first matters the consortium has to deal with is the appointment of external advisors. External advisors provide general support, expertise, and resources to prepare tender documents on time. The areas covered during the tender stage are technical, legal, and financial in nature.

### ***Determining the Corporate Structure of the SPV and the Structure and Type of Contracts Entered into by the Private Party***

The SPV is the vehicle that implements the PPP project. It is comprised of shareholders, and will adopt a limited recourse structure with project obligations being passed through to the construction and operation and maintenance (O&M) contractors. These contractors may be members of the consortium if it is structured in such a way that they will be both future equity shareholders and contractors.

The SPV needs to ensure that all its project agreement obligations are made completely known to the key PPP project contractors.

### ***Preparing and Submitting the Technical, Financial, and Legal Proposals***

The preparation of the consortium's bid involves the completion of technical, financial, and legal proposals. While these proposals are being prepared, the consortium will develop and agree on the structure of the project vehicle to implement the PPP project. The consortium will also agree to the matrix of contracts that will be entered into between the project parties, assuming that the project is awarded to the consortium. These contracts will set out the obligations of each PPP project party, the level of risk they will assume and manage, and the level of award/remuneration they will receive.

The technical proposal will have to be endorsed by the construction and O&M contractors and the sponsors. Equally, the financial proposal, and notably the financial strategy and the risk/award assessment will need to be endorsed by the sponsors. Similarly, the legal details will need to be endorsed by the sponsors.

### ***Bid Preparation and Decision to Submit***

Only when an investor decides to participate in a tender does the bid preparation actually start. In parallel to the bid preparation, investors will carry out the project's due diligence to decide whether or not to proceed with the submission of a response to the RFP.

Preparing a bid does not necessarily mean making a decision to invest. The decision to respond to the RFP is made only if some conditions/targets are met.

### ***Technical Issues***

The technical process will provide two main outputs: the technical bid package and the assessment of costs, specifically capital expenditure (Capex), operating expenditure (Opex), and life-cycle cost (LCC). These technical outputs will be taken into account in building the financial model/outputs and the price negotiations for construction and O&M.

### ***Financial Issues***

The financial team will identify and help obtain the best sources of project finance, such as debt and equity. The financial model reflects the financial structure of the consortium's proposal. It will also be used as a tool to help refine the financial impact of any changes to the consortium's proposal that might be agreed during negotiations with the procuring authority and/or the PPP project funders.

### ***Legal Issues***

The legal team will review the procuring authority's documentation, and it will prepare the legal package to be submitted to the sponsors (for their endorsement) and the procuring authority as part of the tender response. It will draft and agree the heads of terms (HoT) relating to the construction and O&M contracts, as well as the drafting of the contracts themselves. The legal team will also draft the shareholders' agreement and the finance legal documents. It will also ensure a complete pass through of the consortium's obligations into the construction and O&M contracts.

### ***Fundraising***

Fundraising is a process that starts during bid preparation. However, it is only concluded after the award of the PPP project to the consortium. Before funding is provided, the funders will want to ensure the robustness of the project risk allocation. Funders will ensure they are protected against the adverse effects of PPP project risks through terms included in the finance documents and the security package.

The credit/loan agreement is the key financing document. Meeting the required financial ratios, such as loan life cover ratio and annual debt service cover ratio, help to ensure the financial robustness of the project.

### ***Commercial and Financial Close***

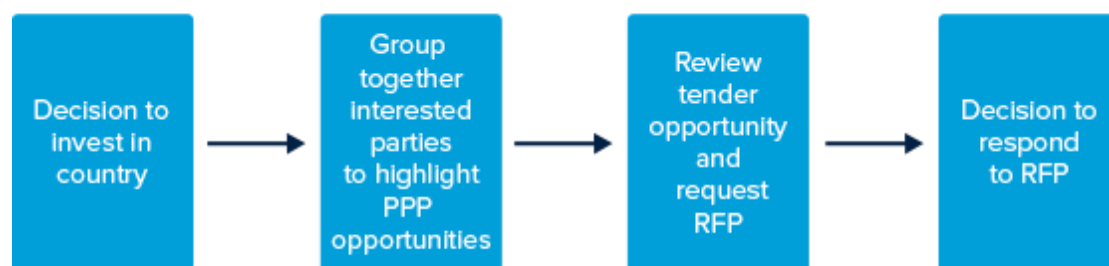
If the consortium successfully secures the award of the procuring authority's PPP project, then it will normally be referred to as the preferred bidder. From the date of its appointment as the preferred bidder, the consortium will be

required to complete a number of activities to ensure that it is able to enter into the project agreement at the required time. These activities will include finalizing all the PPP project contracts, including the construction and O&M contracts, and forming the SPV.

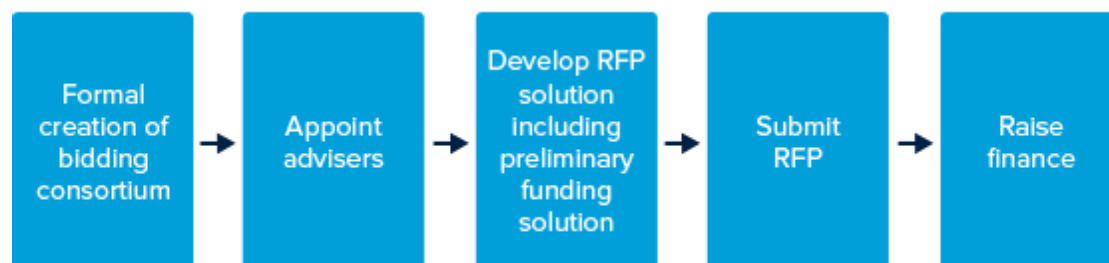
When all of the PPP project's commercial issues are agreed and solved then it has achieved commercial close. Financial close occurs when the PPP project funding becomes available. Normally, commercial close and financial close happen simultaneously or in quick succession. See figure 6A:1.

*FIGURE 6A.1: Private Partner PPP Pathway*

**Preliminary stages up to decision to bid for the PPP project**



**Active bidding stages interacting with procuring authority and lenders**



*Note:* RFP= Request for Proposal.

## **6.2 How the Private Party Targets Markets and Selects PPP Projects**

There are many private parties involved in a PPP project and each has its own specific reasons for investing in such a project. Influencing factors include a party's investment appetite, together with its corporate strategy; the mandate it has to invest in specific sectors/countries; and how expensive or costly it is to bid for PPP projects in a particular country.

The level of PPP activity in a market will be influential too. A large number of existing PPP participants may reveal there is too much competition for a private party to deliver a winning bid. Too few PPP participants may indicate a lack of market liquidity. However, on occasion, a private party may simply form a view that a specific PPP project represents a good business opportunity and this will mean that it decides to become involved.

Each private party will have a different perspective as to what is the right investment for it. Some will be looking for a long-term investment, and a PPP project with a long 20–30 year term will be highly attractive. Others, such as the construction contractor may prefer to invest for the short-term only, managing the preliminary PPP project stages (design and construction) and exiting after the PPP project asset has been constructed. Some private parties will be O&M providers, and for these parties the prospect of a PPP project providing significant long-term operating revenues over a 20–30 year term is attractive. Normally, at the time a private party takes a decision to invest in a PPP project, it will also have an idea of how long it will remain committed to the PPP project and when it will exit.

### **6.2.1 Targeting Markets**

The most attractive markets for a private party are ones that offer predictable and strong growth potential with high or adequate levels of return, and those that provide business-friendly environments within which to work. The attractiveness of any market, however, may be diminished by the risks present in it. As seen later in this section, a private party needs to ensure that any country or market risk, such as political risk or currency fluctuation risk, can be controlled. For example, a change in a country's government might herald in the introduction of a new political policy that prohibits PPP projects and results in current projects being terminated.

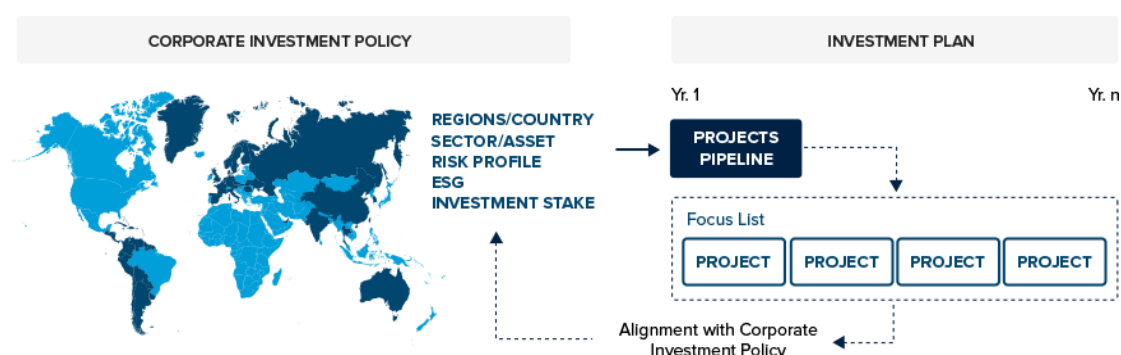
A private party goes through a structured process to identify where in the world and in what sector it wants to invest. Identifying the best investment opportunities involves several considerations.

- Appropriate target regions/countries (balancing long-term prospects versus political, financial, or regulatory risks<sup>16</sup>);
- The class of infrastructure assets in which to invest;
- The extent of secondary market activity which could provide options to sell/exit the PPP project;
- The risk profile of PPP projects and the procuring authority's expectations regarding the degree of risk transfer to the private party;
- The acceptability of the environmental, social, and regulatory policies applying to the PPP project; and
- The role the PPP private party wants to play when managing the PPP project asset: passive or active.

Such considerations also involve an assessment of how these factors are viewed relative to a private party's capabilities and experience.

Based on the conclusions reached after consideration of these factors, a private party will decide on those countries and assets in which it will invest. The decision made will be formalized through the creation of a short list/focus list of target countries, assets, and specific projects (if known). Many private parties refer to this short list as their projects pipeline. See figure 6A.2.

FIGURE 6A.2: Origination of Project Pipeline and Focus List.



Note: ESG= Environmental, Social and Governance

<sup>16</sup> For further reading on the effect of regulation, see Sirtaine, Pinglo, Guasch, Foster, *How Profitable are Infrastructure Concessions in Latin America? Empirical Evidence and Regulatory Implications*, 2005.



### **6.2.2 Project Selection – Screening the PPP Project**

Once a decision has been made to target a particular market, as identified in the projects pipeline, it will then be necessary for a private party to make a decision about a specific PPP project, and particularly, whether it constitutes a good business opportunity.

The projects pipeline will be reviewed and updated regularly by the private party's business development and investment teams to check on how it is being implemented. There may be a number of PPP projects that the private party is provisionally interested in pursuing. However, its decision to go ahead with a specific project is taken after it has received and considered a large amount of information.

A key stage in the private party's PPP project selection process is the point at which a procuring authority announces its PPP project to the market. Such an announcement may be through formal channels (such as an official announcement in the Official Journal of the European Union), or it may be made informally through direct approaches to interested parties or by advertising in newspapers, trade journals, or on the procuring authority's website.

Much more information about the PPP project will normally become available when the PPP project is announced. The additional information that is made available will assist a private party in carrying out its PPP project screening. Screening the PPP project is another key stage in the private party's selection process; the information a procuring authority makes available will be highly influential in helping a private party to conduct its PPP project screening.

It is good practice for a procuring authority to ensure that the information provided is as robust as possible. Sometimes, however, the information provided is less than expected. In this situation, a private party will rely on its experience of carrying out similar PPP projects/transactions and on business intelligence to assist it in with PPP project screening.

The PPP project screening involves consideration of a significant amount of information relating to a PPP project, including a review of the PPP project's general commercial, technical, and financial requirements, together with an analysis of the PPP project's risks. The information will be used to help a private party assess the PPP project's commercial viability. See figure 6A.3.

*FIGURE 6A.3: Project Evaluation Memo (PEM) and Preliminary Due Diligence Risk Check*



Using the PPP project screening information, a private party will make its initial decision as to whether to proceed with the PPP project (that is, to proceed with a full assessment of the PPP project and the preparation of a bid). If the result of the PPP project screening is satisfactory, then the private party may decide to progress with the PPP project, particularly if it perceives that it has a good chance of a successful bid.

Alternatively, even after completing a PPP project screening, it may consider that it needs to conduct further analysis and obtain more information. Obtaining additional information may help a private party to decide to proceed with the PPP proposal, but it may also lead to a negative decision and the PPP project being rejected by the private party.

A private party needs to be mindful of the costs associated with bidding for a PPP project; this assessment is a key element of the PPP project screening. The costs of bidding need to be proportionate to the financial/investment advantage that the PPP project will deliver to the private party. The PPP project screening will therefore include an assessment of bid costs: obtaining project information from the procuring authority; attending meetings in an overseas jurisdiction; instructing local advisers; and using personnel to prepare the bid.

Additional factors to consider are the preparedness of the procuring authority to conduct the PPP project procurement efficiently, and its previous track record in concluding projects quickly. A procuring authority with experience of conducting efficient and quick procurements will give a private party some confidence that its bidding costs will not escalate unexpectedly throughout the procurement process.

The private party will also consider the cost of any physical due diligence it is required to do before submitting its bid. For example, there may be a requirement to carry out a geo-technical survey. If this is expensive to do, then it may act as a barrier to entry; a private party may not want to incur the cost of an expensive survey with no guarantee that its bid for a PPP project will be accepted. As such, when a procuring authority is considering its tender requirements, it is useful for it to consider the costs of meeting these requirements and how such costs may influence whether a private party bids or does not bid on a PPP project.

Assuming that the PPP project screening is positive, the private party will begin its search for partners and advisors to work with it. When the private party has found complementary partners, it will form a bidding consortium with

them (see section 6.4). At this stage, each of the key private party partners in the consortium will normally be referred to as sponsors.

In summary, the decision to become involved in a PPP project depends on the following factors outlined in box 6A.1.

### **BOX 6A.1: Factors Considered when Pursuing PPP Markets and Opportunities**

#### **Factors to select countries or markets**

- *Region/Country*
  - *Political and legal risks.*
  - *Investment grade/credit rating.*
  - *Macroeconomic forecasts: gross domestic product (GDP), inflation, currency.*
  - *Foreign investment rules.*
  - *Investment appetite.*
  - *Long-term stability.*
- *Market/Sector*
  - *Policy and regulations: supply, price, and tax.*
  - *Competition and procurement rules.*
  - *Market size and expected growth: existing and future demand.*
  - *Competitors and partners.*
  - *Procuring authority preparedness and track record.*
  - *PPP program: robustness/attractiveness and tender rules (stipend, duration, and so on).*

#### **Factors to select opportunities**

- *Investment size.*
- *Whether the qualification criteria can be satisfied.*
- *Bankability.*
- *Return on investment and potential for profit throughout the asset's life cycle (equity Internal Rate of Return (IRR)).*
- *Key contractual/transactional features: project risk profile and operational period.*
- *Complexity: consents, technical risks (during construction and operational periods), risk of delays, cost overruns, and environmental risks (including climate change).*
- *Benchmarks: existing historical data and (variety of) projects.*
- *Existing forecasts (supply and demand).*
- *Complementarity with sponsor's/investor's existing portfolio.*
- *Perceived chance of success relative to the cost of bidding.*

## **6.3 Bid Preparation and the Decision to Submit a Response to the RFP**

Following on from a successful PPP project screening, and once partnerships have been formed between like-minded organizations in the consortium (see

section 6.4), the two main activities that the consortium will carry out are preparing the response to the procuring authority's RFP and making the investment decision about whether to submit a consortium response to it.

Section 6.7 below sets out all the key activities that need to be completed by the consortium in order for a RFP response to be completed and submitted.

Making the investment decision about whether to submit a RFP requires each individual member of the consortium (each sponsor, see section 6.4.1), and the consortium as a whole to acquire a deeper understanding of the main risks associated with the PPP project. Specifically, there needs to be consideration of how such risks could be allocated and managed by consortium members if they decide to submit a RFP<sup>17</sup>. Accordingly, each consortium member will carry out a more in-depth assessment of the PPP project risks because: (i) each sponsor will need to assess whether its organization should make a decision to proceed with the PPP project; and (ii) all sponsors, acting together as the consortium, will need to take a collective consortium decision about whether to proceed with responding to the RFP.

Both the sponsors and the consortium will require a full analysis of the commercial risks associated with the procuring authority's PPP project, including an appraisal of any threats to the forecasted project revenues. Additionally, consideration will be given to any regional or country risks.

Local intelligence about PPP project specific issues, such as the stability of the local environment where the PPP project will be implemented and the preparedness of the procuring authority to run its PPP project tender, will also be important to know. These factors will influence the sponsors' and the consortium's decisions. Politically unstable environments (for example, where are elections due) create a risk that a new government might not support the procuring authority in its PPP project proposal. This will cause concern. Similarly, if the procuring authority lacks sufficient personnel or is not adequately prepared and organized to run its PPP project tender, then this too will be of concern to sponsors and the consortium.

Concern arises because if any of the risks materialize, the successful operation of the procuring authority's PPP project tender could be jeopardized

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<sup>17</sup> See McKinsey & Company, *A Risk-Management Approach to a Successful Infrastructure Project. Initiation, Financing and Execution* (2013) for details on how to establish an integrated enterprise-risk-management (ERM) approach.

at any stage and, specifically, before the final award of the PPP project. From the consortium's and each individual sponsor's perspective, neither will want to expend its time, money, and energy bidding for the PPP project if there is a significant risk that it might be aborted midway through its procurement. It is therefore good practice for the procuring authority to provide evidence of governmental support for its PPP project, and to give evidence to bidders that it is suitably prepared to run the PPP project tender.

An additional area of concern for sponsors and the consortium is the PPP project's procurement timetable. Sponsors and the consortium will require an assurance that the suggested procuring authority's procurement timetable is achievable. Project sponsors and the consortium will dislike taking part in a bidding process that does not proceed according to a robust and appropriate timetable. Frequent timetable changes will erode their confidence in the PPP project unless there are objectively good reasons for changes, or the changes are requested by a private party.

The sponsors and the consortium also frequently require an assurance regarding the procuring authority's preparedness<sup>18</sup> to run its PPP project tender, the quality of the PPP project's contractual documents, and the support the PPP project has from within government. Such assurances will provide some comfort that the risk of a PPP project being aborted has been mitigated.

This analysis will normally be carried out using the sponsors' in-house resources, typically their business development team or their investment team. When carrying out this exercise it is important that the sponsors have broad experience in identifying and managing risks similar to those likely to emerge in the PPP project. In this context, the sponsors' previous experience will mean that they will know what points/issues are of concern when carrying out the analysis. In some instances, the sponsors might also hire external/independent experts to help with this task.

On completion of its analysis, each sponsor will let its fellow sponsors know of its decision to participate and continue its involvement in the bidding process. These decisions will normally be discussed during regular consortium meetings known as steering group meetings – see section 6.4.3. Further, the

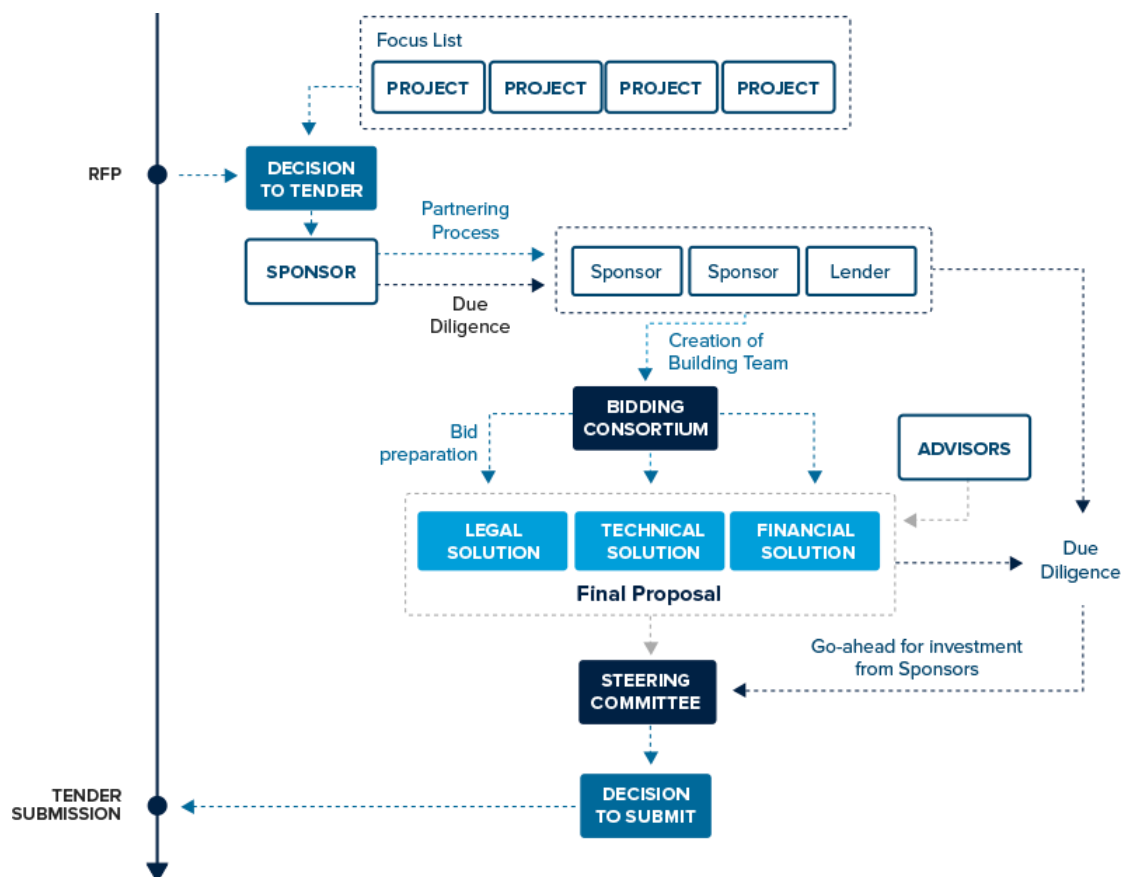
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<sup>18</sup> There is evidence that lack of preparedness may facilitate opportunistic negotiations over aspects of the PPP project. See Engel, Fischer and Galetovic, *Public-Private Partnerships: When and How*, 2000.



decision of each sponsor will be taken into account when the consortium makes its decision on whether to submit a RFP response. See figure 6A.4.

*FIGURE 6A.4: Bid Preparation and the Decision to Submit a Response to the RFP*



Note: RFP= Request for Proposal.

## 6.4 Putting a Consortium Together

Following a successful PPP project screening, partnerships will be forged between like-minded organizations and a consortium will be formed with a view to responding to the procuring authority's RFP.

Implementing the PPP project will require the implementation of material construction, operations, and maintenance activities. This means that the consortium will normally be made up of sponsors representing these interests. In practice, it is normal for the consortium to include a construction contractor, a service provider, an operations and maintenance provider, and an identified lender.

Collaborative working in a consortium has many advantages. It facilitates the development of innovative project solutions, including how commercial risks should be managed. It may also help combine different sources of project funding and complementary business aims. It will ensure too that bidding

costs are shared among the consortium members. Its value comes from the proper combination of the members' strengths, capabilities, and resources.

Forming a consortium may also be a prerequisite to submitting a RFP because many RFPs require a strength and depth of project experience that can only be provided by multiple parties 'pooling' their experience as part of a bidding consortium.

Working together in a consortium needs to be carefully managed. Significant efforts must be focused on finding the best partners for the PPP project. In some cases, due diligence is carried out by one partner on another in order to obtain assurance about its technical and financial capabilities, experience, and reputation. The principles to take into account for a productive and effective partnering, and consequently, for ensuring a successful consortium are as follows.

- Early involvement of key sponsors across institutions;
- Commitment of each of the sponsor's senior management;
- Common goals between sponsors;
- Clear understanding of responsibilities, risks, and rewards between the consortium's members and key suppliers;
- Identification of key individuals/teams who will work together;
- Selection of bidding partners based on value (not price);
- Common cultural values and processes across consortium members and key suppliers;
- Ideally, practical experience among consortium members of having worked together and of having built successful joint bidding/working teams;
- Previous PPP experience and track record of consortium members; and
- The relationship a proposed partner has with the procuring authority.

#### **6.4.1 Consortium Members**

The consortium that responds to the procuring authority's RFP will typically include the following key private partners, all of whom may be required to bid together on an exclusive basis.

- The **sponsor** is the party (or parties) who will assume a leading role in the PPP project during the investment life cycle. However, it should be noted that some project sponsors will not want to have an active role, so they will just be equity investors.

Sponsors create the consortium for the sole purpose of bidding for the PPP project. As will be seen below, it is the consortium that will eventually become the SPV implementing the PPP project. The sponsors (or their parent companies) often have to provide guarantees or enter into management or service agreements to cover certain liabilities or risks.

- The **construction contractor** (or construction team) is the party (or parties) that will be responsible for designing, building, and commissioning the PPP project asset during the Construction Phase. It includes designers, technical specialists, civil/Monitoring and Evaluation (M&E) contractors, and all sorts of construction advisors and suppliers. In some cases the construction contractor may also be a sponsor.

During the PPP project tender stage, the contractor will provide the main technical and quality outputs of the proposal as well as the construction/lump sum price (Capex). When awarded the PPP project, the construction partners may incorporate an ad hoc vehicle called a Cooperative Joint Venture (CJV) or Engineering, Procurement and Construction Consortium (EPCC).

Unlike the approach taken by other members of the consortium, in many projects it has been the practice for the construction contractor to exit the consortium once the PPP project asset is built and fully operational.

- The **operations and maintenance contractor** (or operations and maintenance team) will be the party (or parties) responsible for operating and maintaining the PPP project asset over its life cycle. At the bidding stage of the PPP project, the O&M team will provide the technical and quality outputs related to O&M, as well as the price regarding operational expenditure and capital/life-cycle expenditure (Opex, operational expenditure and life-cycle costs). When awarded the PPP project, the O&M partners may incorporate an ad hoc vehicle called an Operating Company (OpCo). Like the construction contractor, in some cases the operations and maintenance contractor may also be a sponsor.

In addition, and depending on the specific bidding requirements determined by the procuring authority, the lender (or bank), as the party (or parties)

responsible for arranging debt<sup>19</sup>, may be a consortium party. However, unlike the other consortium members, it will not be an equity participant. The lender might be a commercial bank, an institutional lender, a development bank, or an infrastructure fund.

It should be noted that the role and status of the lender is different to that assumed by the other consortium members. If fully committed finance is required at the RFP tender submission, then the lender will be a “tied-in” member of the consortium. It will normally provide the PPP project funding according to the terms of the RFP tender submission, subject to all parties agreeing to certain changes to the funding solution as required.

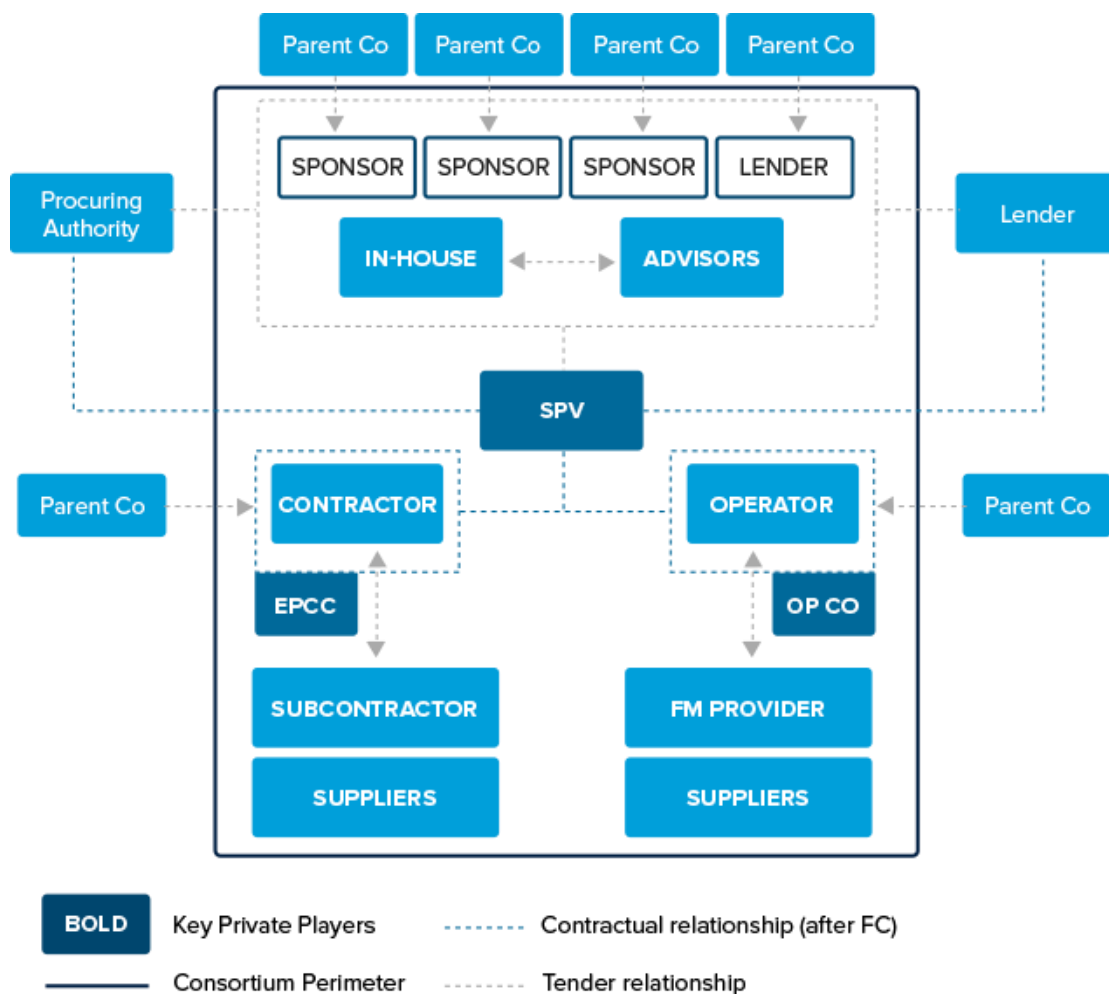
If, however, fully committed finance is not required at the RFP tender submission stage, then the lender will be more loosely associated with the consortium. It will provide indicative financing terms to the consortium and it will demonstrate its intention to support the consortium. However, it will not be until much later on in the procurement, perhaps after commercial close, that it will confirm its funding terms and so become a full member of the consortium by acting as the consortium’s lender.

The consortium may also include members of the contractor’s and operator’s supply chain, such as key sub-contractors and facilities management providers (FM providers). This might happen if supply chain members are providing specialist support and there is a need to “tie-in” their involvement with the consortium, thus avoiding them working with a competitor. See figure 6A.5.

*FIGURE 6A.5: Consortium Members and Key Relationships*

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<sup>19</sup> The debt arranger will usually provide a part of the loan funds. Sometimes it may be committed to provide the whole amount (underwriting) so as to allocate part of the funds among other banks (syndication).



Note: Co= company; EPCC= Engineering, Procurement and Construction Consortium; FC=Financial close FM= facilities management; OpCo= Operating Company; SPV= Special Purpose Vehicle.

#### 6.4.2 Consortium Agreements

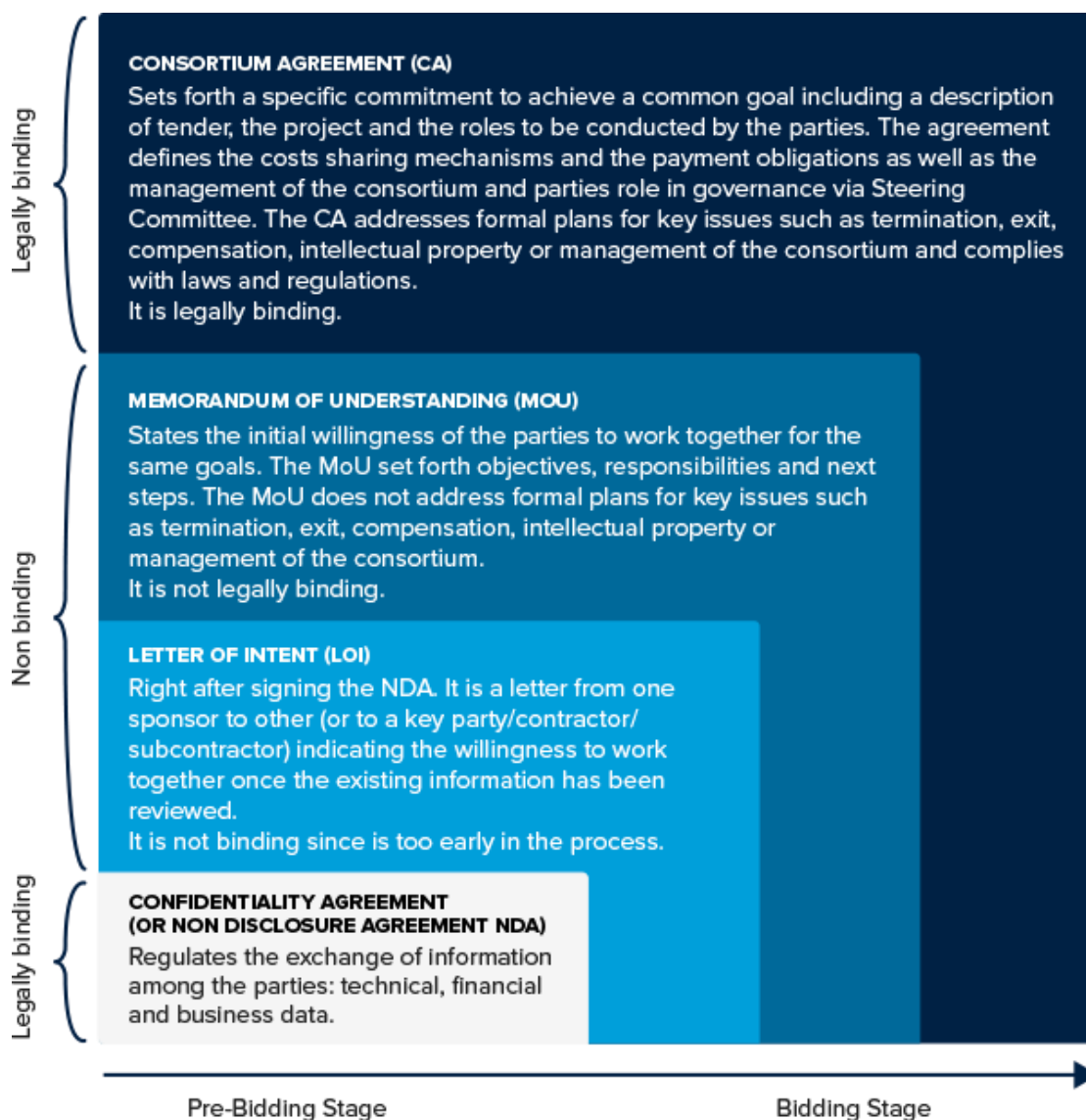
Once the consortium is formed, the next requirement is for the sponsors to put suitable bidding arrangements in place. These will normally take the form of a Letter of Intent or Memorandum of Understanding that will be entered into by the sponsors, which will set out their intention to bid together, normally on an exclusive basis. These agreements may not be binding. However, a more formal and binding agreement, known as a “consortium agreement”, may be agreed to by the sponsors.

The consortium agreement and the other associated agreements referred to above will set out how the consortium will operate, together with the rights and responsibilities of its members. Each member’s responsibility for carrying out and meeting/sharing the costs of bid development will be documented, as well

as how parties will take decisions and work collaboratively. Specifically, the procedures and decision-making mechanisms to ensure proper governance of the consortium will be documented (for example, the creation and use of the steering committee for significant decisions – see section 6.4.3). See figure 6A.6.

The importance of the Consortium Agreement should not be underestimated. This agreement will form the basis of the shareholder's agreement. It will influence the private party's project structure and governance, and the allocation and responsibility for the management of project risks between the consortium parties. It is customary too that the sponsors will enter into a confidentiality agreement, meaning that they will agree to keep each other's commercial information confidential at all times.

*FIGURE 6A.6: Sequence for Bidding Agreements*



There is no standard practice with regard to partnering. However, there are some methodologies (that is, “BS 11000 Collaborative Business Relationships”) that can be used to help develop and manage relationships between companies in such a way as to maximize efficiency.

### 6.4.3 Governance Procedure for Decisions and Approvals Relating to the Bid

Adopting good governance practices that embody accountable and transparent decision-making will help reinforce each consortium member’s responsibility to the other. The practices should help eliminate ambiguous project risk sharing and ensure that proper procedures are put in place to resolve disagreements between members.

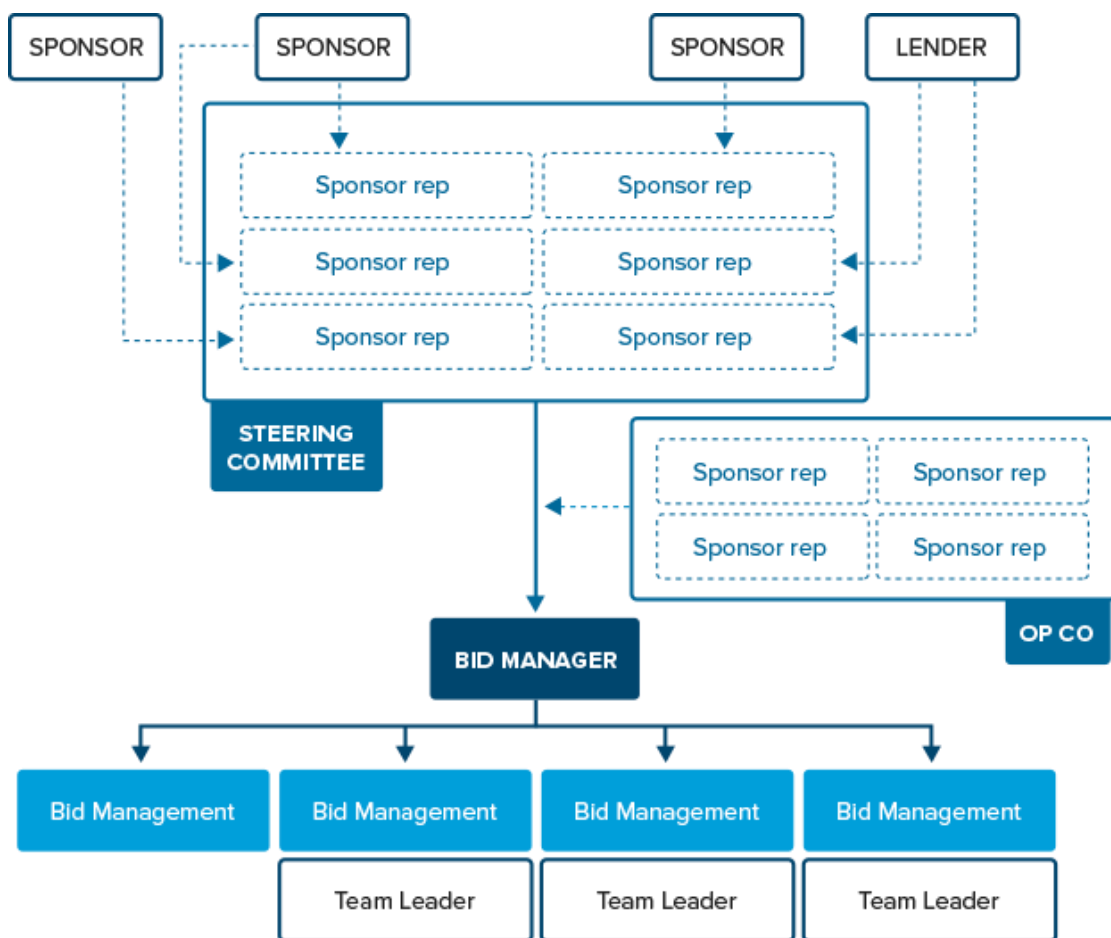


During the bidding process it will, therefore, be necessary to put into practice effective governance mechanisms to determine how best to run the RFP response preparation and to ensure that all members of the consortium are fully accountable. The most common way of doing so is by establishing a steering committee.

The steering committee will support the bid manager (see section 6.7 for a list of the bid manager's responsibilities) in its role of ensuring that the preparation and submission of the RFP response is carried out properly and always meets deadlines. It will also support the bid management team, including those individuals who are responsible for taking key decisions about the content and progress of the RFP response. In practice, this will mean that the bid manager/management team will provide regular reports to the steering committee on arising PPP project issues. The steering committee will consider these and make decisions on the basis of the received reports.

The cornerstones of good project governance are the steering committee, the sponsors, and the bid manager and team. See figure 6A.7.

*FIGURE 6A.7: Consortium Governance over the Tender Process*



Note: Rep= representative.

Senior representatives from the sponsors comprise the steering committee (SC).

- The SC follows a formal framework that defines its role in relation to the bid management and the governing bodies of the sponsors/parent companies;
- SC members must be mandated/authorized to take the necessary decisions by their respective sponsors/parent companies;
- The SC defines and promotes the principles and objectives of the bidding team;
- The SC agrees to the bid strategy after input from the sponsors;
- The sponsors appoint the SC members depending on their number of shares;
- The number of SC members should be appropriate (no less than 4 and no more than 10);
- A chairperson and a secretary should be appointed;

- The SC empowers and provides direction to the bid manager in order to define acceptable risk profile/thresholds and maximize the bidding team's options; and
- The SC will approve the bid closure after obtaining approval from the sponsors.

Steering committee meetings will normally take place on a regular basis. It should be noted at this point that the steering committee, the bid manager and the team are in charge of managing and organizing the bidding process from the private party's perspective. As explained later, there will always be a working team structure (not included in the above exhibit) that will be in charge of preparing the technical, legal, and financial solutions.

Prior to submitting the bid, each individual sponsor must obtain approval from its internal investment committee. Since each sponsor normally has different procedures and requirements (that is, different information may have to be provided, there may be different dates fixed for internal committees meetings, and so on), the bidding team must be prepared to provide project information to each of the sponsors well in advance of the procuring authority's tender submission date.

Additionally, the consortium as a whole must obtain the approval of the steering committee to submit its bid because the decision to submit a final RFP response constitutes a formal decision to invest. Consequently, in order to submit a RFP response, all members of the consortium must be fully aligned and agree on its terms and conditions. If one sponsor cannot agree on an issue relating to the RFP response, meaning that there is no general agreement among sponsors, then it will be difficult for the consortium's response to be submitted. In such a situation, it will be the steering committee that will try to broker an agreement. Once this is achieved, the RFP response can be submitted.

One of the most important governance challenges the steering committee faces is the need to deal with and manage disputes among the sponsors. Some sponsors might not be 100 percent aligned with each other, or they might be unable to adopt a consistent approach to the PPP project risks. Both situations would undermine the consortium's ability to prepare a competitive bid and deliver Value for Money. To deal with key decision-making and conflicts of interest, it is normal to have in place the following procedures and mechanisms:

- A structured voting procedure identifying decisions to be adopted by simple majority, qualified majority voting, unanimity voting, and reserved matters;
- A deadlock mechanism and reference to independent experts;
- A dispute resolution procedure that may involve recourse to alternative forms of dispute resolution, such as mediation or arbitration; and
- Recognized situations in which recourse to the senior management of the parent companies is required.

As noted, typically the governance procedures and the mechanisms in place during the bidding process will be incorporated into the shareholders' agreement.

## 6.5 Bringing Advisers on Board

Specialized knowledge is required to ensure a winning bid, and the consortium bidding for the procuring authority's PPP project will be keen to put this in place as soon as possible. Despite the fact that large sponsors have internal resources that can be used to deal with the preparation of the consortium's RFP response, it is common practice to use external advisers as well. See diagram 6A.8 below that sets out how the consortium's sponsors and staff work together with external advisers.

External advisers will work alongside the consortium's members to support and assist them in their review and assessment of the procuring authority's PPP project, and in particular, the review and assessment of the documentation issued by the procuring authority.

External advisers will provide specialist technical, legal, and financial advice, as well as general support to enable timely preparation of tender documents and deliverables. Some advisers, although not all, may provide additional bid planning and management services.

External advisers to the consortium will provide advice to the consortium as a *whole*. Each sponsor may also have its own independent adviser.

Making significant decisions for and on behalf of the consortium is, as a rule, outside the advisers' scope of work. However, the external advisers, in their supporting role, will ordinarily act as the 'agent' of the consortium. External advisers used by the consortium will attend meetings called by the procuring authority, and they may respond in writing to questions raised. However, they do so in consultation with and after taking advice from the bid manager and

ultimately the consortium members. As such, their role is to act as the conduit through which the consortium's views will be expressed.

External advisers do not determine what these views are. Indeed, that is the sole function of the consortium. However, by virtue of the advice provided by the advisers to the consortium, the advisers can rightly be said to have helped shape and influenced the consortium's decisions. Occasionally, the consortium may receive conflicting advice from advisers, and in such situations the bid manager or the SC will act as the final arbiter and determine the way forward.

The typical areas covered by the external advisers are legal, technical, and financial.

FIGURE 6A.8: Bid Working Team: Areas of Responsibility and Main Activities.

Legal Team	Technical Team	Financial Team
Team Leader	Team Leader	Team Leader
Working Team	Sponsors in-house Staff	& External Advisors
Legal Team	Technical Team	Financial Team
<b>AREAS COVERED</b> <ul style="list-style-type: none"> <li>• Legal risks</li> <li>• General legal (international and local)</li> <li>• Contract drafting</li> <li>• Support in negotiating contracts</li> <li>• Legal Due Diligence</li> </ul> <b>ACTIVITIES</b> <ul style="list-style-type: none"> <li>• Review of RfP legal aspects, providing advice on legal feasibility</li> <li>• Preparation of contractual drafting.</li> <li>• Draft responses to legal clarifications</li> <li>• Liaise with legal Advisors from Grantor, Lenders and Contractors</li> <li>• Participate in meetings with the Grantor</li> <li>• Support negotiation of payment mechanism</li> <li>• Preparation of final contractual drafting</li> </ul>	<b>AREAS COVERED</b> <ul style="list-style-type: none"> <li>• Technical risks</li> <li>• Technical design</li> <li>• CapEx and OpEx</li> <li>• Life cycle costs</li> <li>• Demand &amp; Revenue</li> <li>• Environment</li> <li>• Tech. Due Diligence</li> </ul> <b>ACTIVITIES</b> <ul style="list-style-type: none"> <li>• Review of RfP technical aspects</li> <li>• Preparation of technical submission</li> <li>• Draft responses to technical clarifications</li> <li>• Liaise with Tech Advisors from Grantor, Lenders and Contractors</li> <li>• Participate in meetings with the Grantor</li> <li>• Drafting of technical provisions for contracts</li> <li>• Prepare final technical bid package</li> </ul>	<b>AREAS COVERED</b> <ul style="list-style-type: none"> <li>• Financial Risks</li> <li>• Financing, structuring and hedging</li> <li>• Financial cost &amp; model</li> <li>• Tax &amp; Accounting</li> <li>• Insurance</li> <li>• Transaction advisory</li> </ul> <b>ACTIVITIES</b> <ul style="list-style-type: none"> <li>• Review of RfP financial aspects</li> <li>• Developing the FM Identifying financing structures and sources of finance and grants</li> <li>• Identification of optimal funding solution</li> <li>• Preparation of financial submissions</li> <li>• Negotiate with funders Liaise with lenders' model auditors</li> <li>• Advising on PIM and other financial terms</li> <li>• Participate in meetings with the Grantor</li> <li>• Fundraising</li> <li>• Project risk assessment</li> <li>• Prepare final financial package</li> <li>• Assist in completing interest rate and currency hedging at FC</li> <li>• Advice on tax and accounting</li> </ul>

*Note:* CapEx= capital expenditures; FC= financial Close; OpEx= operation expenditure; PIM= Project Information Memorandum ; FM = Financial model; RFP= Request for Proposal.

The consortium will be aware that it is advisable to start using expert advisers, whether in-house or external, as soon as possible — and certainly by the time a decision has been taken by the consortium to go ahead with a PPP project. If not appointed early, there is a risk that the best advisers will not be available and might be advising competitors.

In some instances, and depending on the complexity of the PPP project, the consortium may choose a large international multidisciplinary consultancy firm to provide all (or the majority) of the required advisory services at once. Normally, however, the consortium will appoint several specialized advisers for particular tasks, such as advising on just technical or financial aspects of the project.

Typically, the consortium will try to secure the best international external advisers. The importance of using local advisers should not be underestimated, and it is common for the international advisers to help select suitable local advisers.

Working with leading regional/local advisers (likewise with local bidding consortium partners) is essential and the consortium should expect to obtain such advice. This practice will help ensure that the consortium gets a good understanding of the local context of the PPP project, including project risks. Having local advisers will also facilitate the development of relationships and meaningful interaction with local stakeholders, policy makers, and local communities because local advisers will be working in the same environment. The consortium will be keen to develop these relationships.

The key considerations to take into account when the consortium appoints advisers can be summarized as follows;

- Professional advice is about people and skills: the consortium will therefore want to ensure that key individuals from the adviser community are available for their PPP project;
- The length of time taken to appoint advisers can be considerable. Consequently, the timing of their appointment must not jeopardize compliance with the procurement timetable;
- Advisers should have the relevant experience, capacity, and resources to deliver on time and quality work through the tender process. It would be helpful if they had experience in working with the procuring authority;
- Advisers should provide an assurance that the advisory team initially appointed will be the team that advises throughout the tender process;
- Advisers should have no conflicts of interest and should confirm this to the consortium on a regular basis. Where an advisory organization has

multiple teams advising multiple bidding consortia, then they should put in place information barriers (“Chinese walls”) so that there are no breaches of commercial confidences;

- The consortium’s and the advisers’ working cultures must be fully aligned; and
- Advisers’ Terms of Reference (ToRs) must be prepared and structured accordingly in order to ensure Value for Money. These will set out the scope of work that the advisers need to provide and the corresponding fee structure. The ToRs must be drafted to ensure a strong alignment of interests, and a clear definition of goals, deliverables, milestones and incentives.

The appointment of the consortium’s advisers is normally undertaken with the support of the sponsors. The sponsors will have experience of working with certain advisers and will have a good understanding of what activities could usefully come within the advisory scope, as well as the price that should be charged for providing the advice.

However, although sponsors might have preferences when appointing an adviser, the appointment will be a consortium’s decision, that is, a combined decision of the consortium members. When appointing advisers, the consortium will know how important it is to follow a structured procurement process; this ensures the receipt of competitive proposals that give Value for Money and which are transparent.

## **6.6 Determining the Corporate Structure of the Project Vehicle and the Project Contracts**

One of the most important issues the consortium has to address is structure. Its members need to decide the most appropriate structure to adopt in order to finance and implement the procuring authority’s PPP project successfully.

This PPP Guide assumes a project financing approach. As such, normally this means the consortium will create a special purpose company, known as a Special Purpose Vehicle, in order to implement the PPP project. The consortium would not normally adopt an unincorporated joint venture or a partnership type structure.

The financing of the PPP project through project financing means that the sponsors will require protection from the PPP project risks. They will require a limited recourse structure that involves the creation of a SPV. All or most of the PPP project risks that are set out in the project agreement will be



assumed by the construction and O&M contractors. These contractors assume the PPP project risks by means of the SPV 'passing' through the obligations it assumes from the procuring authority under the project agreement into the construction and O&M contracts.

Addressing structure, and taking a decision in relation to it, will be made in the full knowledge that it is the consortium that will be reformed as the project vehicle, and that the sponsors will become the shareholders in that project vehicle.

The SPV will normally be established just before the project agreement is entered into with the procuring authority, that is, at financial close. The members of the consortium will normally be the shareholders in the SPV, together with additional shareholders, such as investors.<sup>20</sup> However, not all consortium members will want to be SPV shareholders. For example, a construction contractor sponsor may decide that it does not want to be a SPV shareholder. Instead, it will decide to be part of the proposal as a nominee contractor.<sup>21</sup> It may wish to focus all its attention on construction activities, rather than becoming involved in all aspects of the PPP project's implementation as members of the SPV are expected to do.

Each member of the consortium (with the potential exception of some nominee contractors) will have to be committed to participate in the future SPV as a shareholder, taking an equity stake in it. Shareholders will hold equity in the proportions defined and agreed to in the shareholders' agreement. The size of an equity holding can vary from very small (pin-point equity) to large. Normally it is the primary project sponsors who collectively hold the largest amounts of equity.

The arrangements set out in the Consortium Agreement (see section 6.4.2) will be reflected in the SPV's constitution and in project contracts entered into by the private party. The Consortium's arrangements relating to working methods, the rights and responsibilities of sponsors, and how PPP project risks and rewards will be shared between sponsors will all be matters that are addressed in the documents entered into to establish the SPV and the other PPP project contracts.

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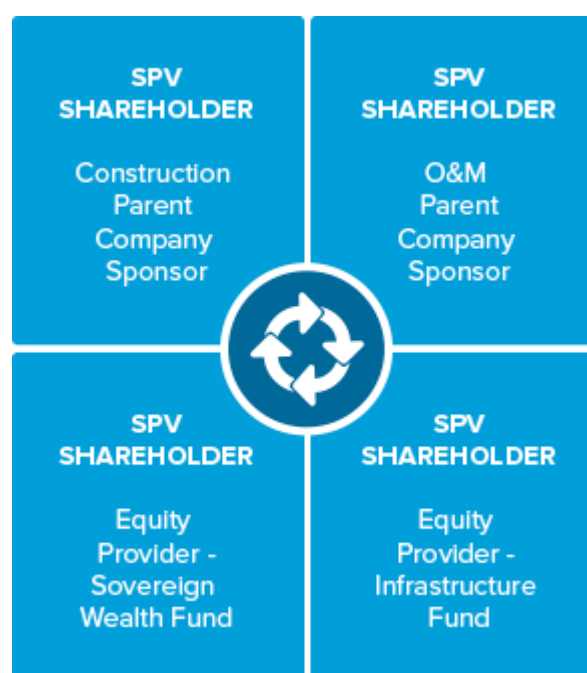
<sup>20</sup> Occasionally the procuring authority may, because of legal requirements, be a member of the SPV. In most cases, the procuring authority plays a nominal/minority shareholder role with a limited role in SPV decision-making. The SPV's constitution will reflect the arrangement.

<sup>21</sup> Noting that in some tender processes it may be requested that the party that provides the construction or the O&M experience be part of the SPV as a shareholder with a minimum equity involvement.

The SPV's incorporation documents will include the SPV's "memorandum and articles of association" and the shareholders' agreement. See figure 6A.9.

Often, there will be a direct link between one of the SPV's shareholders and the construction and/or O&M contractors. Where there is such a link, there needs to be careful management of the relationship because there is a potential conflict of interest between the interests of the SPV shareholder and the linked contractor. In practice, this might mean that one of the SPV's shareholders may be unable to agree with the remaining SPV shareholders to accept a term in the project agreement on the basis that it knows its linked contractor will not be able to meet the obligation.

*FIGURE 6A.9: SPV Shareholders*



*Note:* O&M= operation and maintenance; SPV= Special Purpose Vehicle.

The SPV will be set up with one purpose only — to design, finance, build, and operate the project. The SPV is arguably the main player in the PPP project because of the number of activities it undertakes.

The SPV enters into the project agreement, obtains funding from investors, and contracts with the construction and O&M contractors. All these activities illustrate the key role of the SPV. The consortium will be aware of its key role during the bidding stage and when formed into the SPV. The effect of this is that it places a significant responsibility on the consortium to ensure that the PPP project is structured in a robust way that protects its interests.

In a small number of PPP projects, the procuring authority has been a member of the SPV. This practice is not common, but when it happens there will be differences in how the SPV is set up and operates; for example, the private party may have a different type of shares and the process for dealing with disputes may involve recourse to a governmental body for a decision.

## **6.7 Responding to the RFP and Submitting a Tender Response**

The complexity of the procuring authority's PPP project requires the consortium to adopt a project management approach to ensure that all necessary experts and skills are managed in an effective and timely manner. Upon signing the Letter of Intent (LOI), Memorandum of Understanding (MoU), or Consortium Agreement (CA), and certainly no later than receipt of the RFP, the consortium will ensure that a bid manager is appointed. The bid manager will be responsible for the following tasks:

- Managing the bid submission process on behalf of the consortium;
- Leading and coordinating the preparation of successive RFP responses, if required;
- Leading and managing the completion of key tasks, such as due diligence activities, and commercial and financial feasibility reviews;
- Defining the work program, key tasks, interfaces, critical paths, and milestones that need to be completed to ensure the consortium's RFP is submitted on time;
- Identifying the necessary resources needed to complete the RFP response, such as in-house resources, external advisers, logistics, and so on;
- Preparing the RFP proposal's budget: direct and indirect costs, and contributions from sponsors;
- Drafting proposals for the project sponsors steering committee to approve. These will be key decisions about the approach to take and positions to adopt in the RFP response; and

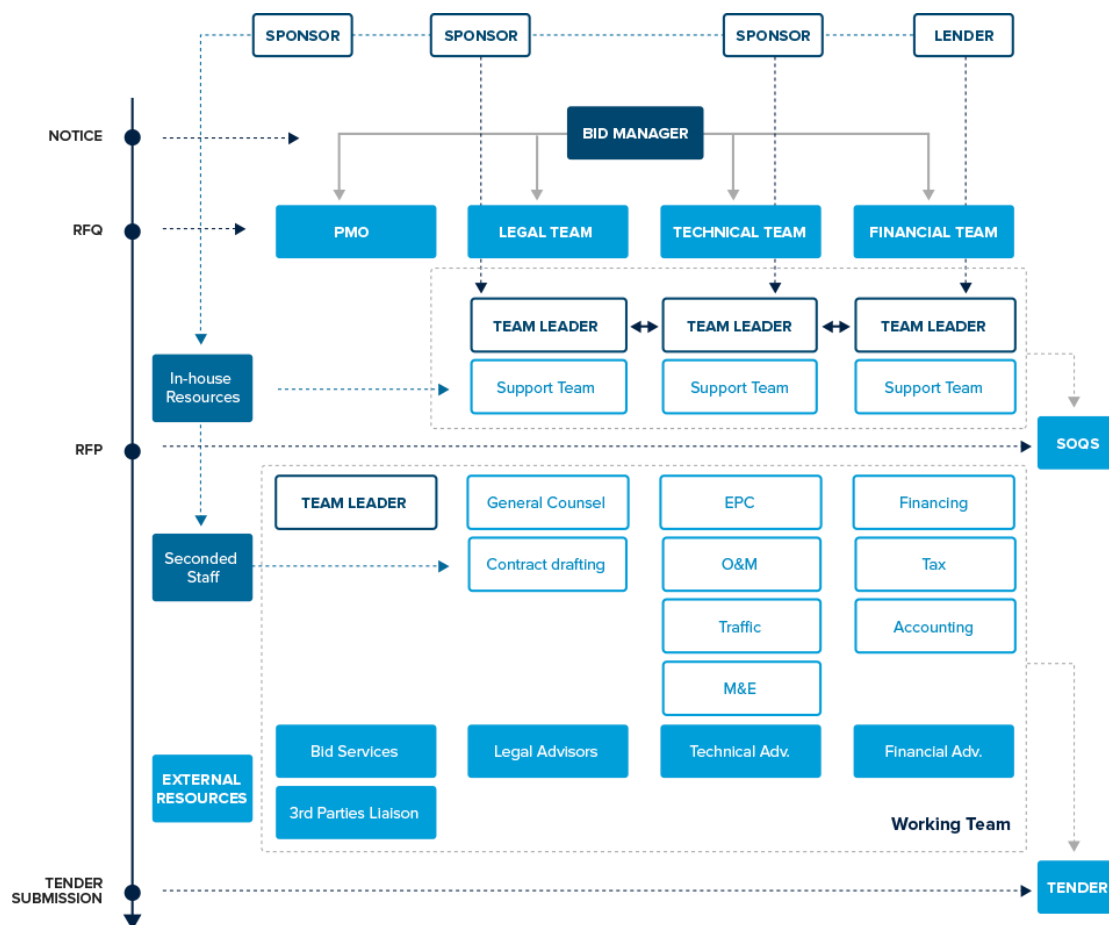
- Dealing with the procuring authority's representative or third parties as and when required.

Typically during the initial stages of responding to the RFP, senior staff from one of the sponsors will assume the bid manager's function on a temporary basis until a permanent appointment is put in place. Likewise, one of the sponsors may provide personnel from its organization to work as part of the bidding team preparing the RFP.

For large and complex PPP projects that have been identified through the sponsors' due diligence, and which are strategic targets for them, it is likely that a bid manager will be put in place before a PPP project has been officially launched. The role of this bid manager will be to monitor the development of the target PPP project for two reasons: to identify when it might be launched into the market, and to liaise with the procuring authority in order to build a good working relationship early on.

Carrying out these activities will help sponsors and/or the consortium prepare in advance for the large and complex PPP project. This will be sound commercial practice, as time will be limited once the RFP is launched; any work that can be done beforehand will be useful.

*FIGURE 6A.10: Bidding Team Resources over the Tender Process*



Note: PMO=Project Management Office; SoQ= Statement of Qualifications.

Once the RFP is released, the bid manager will assume full responsibility for these duties and for the preparation and submission of the RFP response.

As described in figure 6A.10, when preparing the RFP response there are generally three working teams: the legal, technical, and financial teams. Each team will have a team leader and a supporting or working team to provide assistance. In some cases, consortium members may have additional advisers working for each of them. At the beginning of the RFP response preparation, the working teams would normally be made up of internal personnel (the input from external advisers is not very significant at this stage).

As noted, once there is certainty about the tender process and the RFP details, then external resources and advisers are used. These external resources will supplement the existing internal resources provided by the sponsors. Normally when the bidding process is ongoing, there will be key

milestones to be met with their associated deliverables, such as the completion of feasibility studies and assessments.

At times, especially when the RFP proposal preparation work becomes significant, seconded personnel from (one or all) of the sponsors may join the bidding team to assist in preparing final or crucial deliverables. However, this practice will only work successfully if the seconded personnel have sufficient time to devote to the preparation of the RFP proposal. Their complete cooperation is needed so that they become fully active members of the different teams working effectively alongside the external advisers.

From the sponsors' perspective, using seconded staff will help to ensure alignment with the sponsors' corporate guidelines, although it is recognized that the collective views of the consortium members will need to prevail.

In large and complex projects, a Project Management Office (PMO) may be created in order to assist the bid manager. The PMO is normally in charge of setting standards and targets (and ensuring that they are followed), as well as the gathering and production of information for management review and managing/monitoring the tender milestones and deliverables.

It is useful to highlight that responding to an RFP successfully and submitting a tender response is about implementing sound project management techniques in relation to the tender, such as the following:

- Organizing the tender development process: Defining objectives and organizing the right people;
- Planning the timetable for the development and submission of the tender response, including: identification, assignment, and timing of tasks;
- Managing the execution of the tender submission, that is, motivating/focusing the bidding team, making decisions, allocating scarce resources, and monitoring the process;
- Ensuring consistency and the integration of the complementary aspects of the tender response; and
- Learning for future tenders.

Organizing and managing the resources required to submit a bid is a significant exercise and is costly for the sponsors. A proportion of the cost is, therefore, normally included in the final tender price under the heading of "management costs". Additionally, it may be possible for the procuring authority to meet some of the costs, especially where the PPP project's procurement has been protracted.

### **6.7.1 The Technical Solution**

Appropriate management of key technical risks and solutions is a major challenge for sponsors. Getting the right technical solution is not, however, an easy task. Construction is a multi-phase and highly complex industry in which the different phases are carried out by different parties. Apart from inherent technical challenges, there is always a high risk of loss of information, lack of coordination, and poor quality of outcomes.

The technical solution will be designed by the technical team, helped by external specialized consultants, such as engineering specialists who will work under the direction of the technical team leader or a technical committee.

In order to arrive at the optimal technical solution, it is necessary to work toward the best design, that is, a design that is functional, sustainable, efficient, and that meets quality standards. Good design adds value. This can only be achieved with the following factors.

- Proper definition of output requirements and quality standards from the procuring authority;
- Having the best technical advisers on board;
- Clear definition of roles/responsibilities within the consortium as well as the main interfaces; and
- Proper management of a fully integrated supply chain.

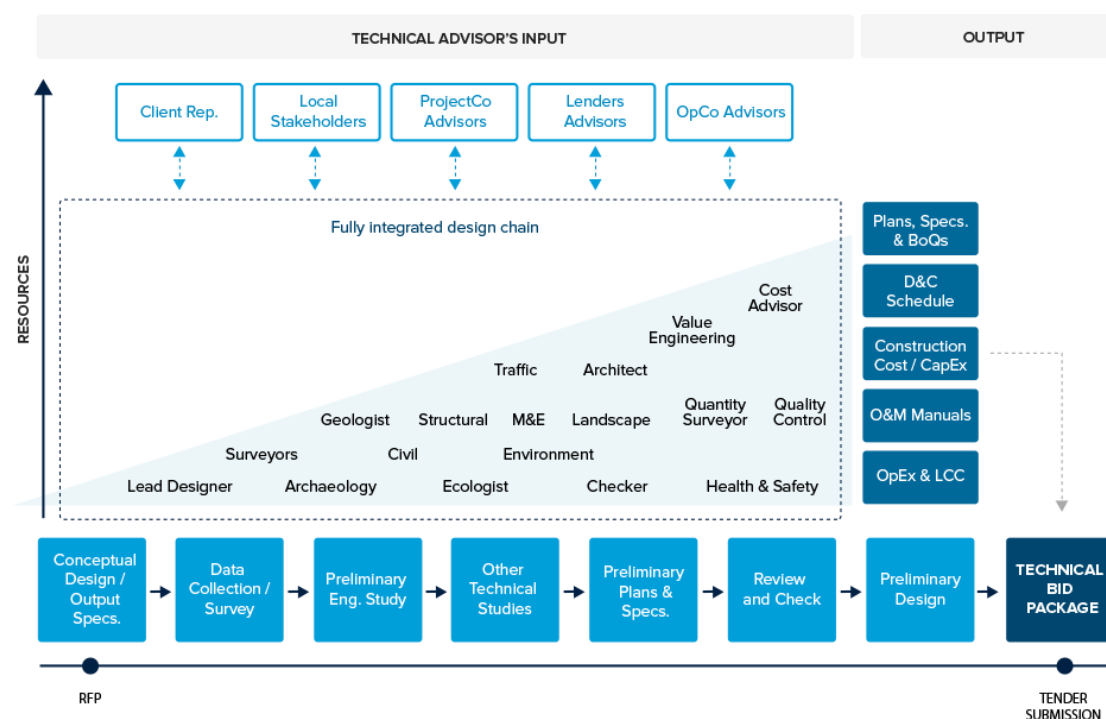
Taking into account the output nature of PPPs, good design should start at the early stages of the tender process. The procuring authority does not normally provide significantly detailed design, technical information, or even technical information that is warranted. In practice, this means that as soon as the tender requirements are well known, the private party must start from scratch in obtaining its own technical information. Despite the fact that some information might be provided by the procuring authority, it is crucial that each private party obtains (directly or indirectly) its own information or set of studies.

In some cases, the procuring authority might provide full PPP project designs or construction requirements. In these circumstances, the private party will not normally assume any risk relating to the accuracy of the provided requirements — unless there is an opportunity to review the final design and to propose design variations and changes of standards.

The main aim of the design process is to define the PPP project scope of work, identify suitable metrics, and assess the costs. The former includes the assessment of RFP technical and quality requirements, the assignment of objectives among the technical team (who is responsible for what), and the development of the conceptual design. The latter includes defining a Design and Construction (D&C) schedule, a Bill of Quantities (BoQs), Key Performance Indicators (KPIs), technical specifications, and a budget/cost for construction (Capex).

Typically, in a PPP project the technical solution will be developed incrementally as the tender process progresses – see figure 6A.11 below. As such, the procuring authority should allow sufficient time in its procurement timetable to enable this to happen. Where the technical solution is heavily reliant on the use of technology, such as the provision of computers in a school, then it will be necessary to assess the proposed technology and upgrade it as the PPP project develops. Only by doing this will the provision of up-to-date technology be assured. The final and definitive technical solution will normally only be developed once the PPP project is awarded. The sooner the final design is ready (and formally approved by the procuring authority) the sooner the construction will start.

FIGURE 6A.11: Design Process and Interfaces



Note: BoQ= Bill of Quantities; CapEx= capital expenditure; D&C= Design and Construction; LCC= life-cycle costs; OpEx= operational expenditure; O&M= operation and maintenance.



Similarly, in relation to the Operations Phase, the starting position is the RFP's output-based and performance-based specifications. These will be taken into account in the project's technical requirements (O&M Manuals). The technical team will produce the long-term O&M plans, as well as an estimate of the operational costs (Opex) and life-cycle costs (LCC) for the PPP project over the duration of the project agreement.

It is well known that higher specifications involve higher construction costs. However, they also lower operational expenditure because maintenance requirements may be less for a PPP project asset with higher specification, as it will normally have a longer life cycle. Conversely, lower construction costs usually result in higher operational costs or larger investments over the life of the asset.

The tension between construction and operational costs means that each of the construction and O&M contractors' approach to costs may conflict. As such, it will be incumbent on the SC to manage this issue and to agree on an approach. It will be crucial however to ensure that whole-life costs are kept to a minimum without compromising quality and outputs. In doing so, benchmarking, cost targeting, and value engineering methodologies must be used.

As noted, the appointment of an experienced multidisciplinary technical team is important. However, it should be emphasized that proper management, straight-forward communication, and full integration of the supply chain is imperative. Only by putting in place the right rules and procedures will it be possible to save time and money — minimizing the chances for errors, omissions, extra works, and/or litigation.

At the end of the technical process, there will be two main inputs: the technical bid package and the assessments of costs associated with the PPP project (costs adjusted to the risk assumed by each party). Subsequently, these outputs will be taken into account to carry out the necessary financial analyses and to build up the financial model/outputs. It is important to highlight that the final (and binding) decisions with regard to Capex, Opex and LCC will be adopted very close to, or just before, bidding submission. Therefore, the sponsors, steering committee, and the bidding team must be prepared to make fast decisions under very tight schedules.

The technical solution will drive the PPP project, and consequently it will form a key part of the project agreement.

IMAGE 6A.12: Key Design and Construction (D&C) Contractual Drivers



Note: D&B= Design and Build; EPCC= Engineering, Procurement and Construction Consortium; PCG=parent company guarantee.

## 6.7.2 The Financial Solution

The financial solution comprises the business case used by the private party to approve its decisions to invest in the PPP project and to submit its bid. It will set out the private party's financial strategy and financial structure (the optimum mix of debt and equity) for the PPP project.

The financial model<sup>22</sup> is one of the tools used by the private party to help it make a financial assessment of the PPP project, and to assist it in structuring its project finance solution.

### 6.7.2.1 The Financial Model

The most important function carried out by the consortium's financial team is to develop its financial model. Normally, the financial team will delegate the preparation of it to a financial adviser and this financial adviser will carry out its development under the supervision of the bid manager and/or the financial team leader if there is one. See box 6A.2. The financial model is necessary to help the consortium prepare its bid, as well as provide the procuring authority with a method of assessing the robustness of the consortium's RFP response.

<sup>22</sup> In practice, the private party may use two financial models: one which is provided to the procuring authority to support the calculation of its tender costs, and another which contains the 'true' cost of the private party's bid and which is for internal use only.

The financial model will be comprised of a number of separate cost elements which will be combined to form the total price that the private party will require in order to implement the PPP project. In practice, there will be, for example, amounts in the financial model that set out PPP project costs (such as construction, O&M, and financing costs). All of these costs need to be added together in order to calculate the total price offered by the consortium.

In terms of assisting the consortium to prepare its bid, the construction of the financial model serves a number of purposes.

First, it assists in the financial analysis of the PPP project, including the payment mechanism, and it is used to assess the appropriateness of the PPP project as an investment opportunity for the consortium. It does this by identifying the relative project risk-return. A favorable assessment will help inform the decision to submit or not submit an RFP response. Most importantly, it will help determine the price and costs of the elements that make up the private party's RFP proposal.

For example, the financial team, or the financial advisers if instructed by the financial team leader, will review the PPP project's payment mechanism and assess predicted project revenues. For "government-pays" projects, the SPV will have made an assumption about the annual unitary charge it needs to receive from the procuring authority in order to deliver the PPP project. Payment to the SPV will, however, be dependent on the delivery of an expected service at an expected level. A failure to deliver this will result in a deduction made against the monthly unitary charge paid by the procuring authority. For instance, in a hospital PPP project, if one of its wards is unclean then it will be deemed to be unavailable and an unavailability deduction will be made.

The financial team will therefore be keen to test how aggressive the proposed PPP project payment mechanism is. This allows them to estimate the likelihood of deductions and the associated effect on the PPP project's anticipated revenues. It will do this by running scenarios and sensitivities using the financial model.

Similarly, under "user-pays" projects where the SPV receives revenue from the user of the PPP asset, for example road users paying tolls, the consortium's financial team will be involved in forecasting both use and revenues. These forecasts will be used to assess if the anticipated use made of the PPP asset, plus any constraints on toll levels imposed by the procuring authority, will generate sufficient PPP project revenues. Again the financial

model will be used to test the scenarios and help inform decisions about the suitability of the PPP project.

Second, the financial model is used as an aid to help the consortium assess certain parts of its RFP response, as well as helping it to assess the overall value and appropriateness of its proposal. For example, the financial model will be used to help determine the fixed construction and O&M prices which are key parts of the overall proposal submitted to the procuring authority. It does this by enabling the consortium to test a variety of prices until it gets to an optimal total price for the PPP project.

Third, the financial model is used to test financial structures and so help determine the type of PPP project financing to be used by the consortium. For example, the funders will specify a set range of sensitivities they want the financial advisers to assess using the financial model. The financial model will therefore run test scenarios, such as assuming a debt- or bond-financed project.

It will also be able to test the impact of different debt terms or strategies (for example, using a short-term or mini-term loan which is then refinanced after construction) on the equity IRR. The benefit of being able to test different scenarios is that it will reveal the advantages and disadvantages of each approach. It will also help in the assessment of the degree of risk attached to the proposed funding. Thus, the financial model will help the consortium decide which funding solution to adopt.

The financial model will also be used to test proposals and counter proposals that are considered during the procurement negotiations. The ability to run sensitivities will also help with the consortium's negotiations with potential funders. The consortium will be able to input the funder's requirements into the financial model to see what effect such requirements will have on its anticipated project return. Where the effects are less favorable to the consortium, it will be able to highlight this to a prospective lender by using the financial model. As such, the financial model becomes a tool used by the consortium to help it negotiate funding terms with its funders.

The financial model is a key component of a project and reflects the financial basis upon which the PPP project has been agreed. It will be submitted to the procuring authority as part of the response to the RFP. It provides a robust assessment of the consortium's costs and revenues inherent in its RFP response. It is the information in the financial model that determines the amount of the annual/ monthly payment that the SPV will need to receive in

order to meet all its cost liabilities. As a consequence, it will be fundamental for the procuring authority's financial advisers to fully understand the information contained in it.

The consortium's financial model is a computer model showing a detailed analysis of the anticipated income and expenditure of the PPP project, its cash flow and balance sheet projections, together with any reserves and contingencies required. It will also include details of the assumptions underpinning the monies set out in the financial model.

The financial model is a necessary component of the consortium's RFP response documentation. It will enable the procuring authority to carry out a robust assessment of the consortium's costs and revenues. It also enables the procuring authority to compare how each private party bidding for the PPP project has structured its financing, as well as the financing assumptions the private party has made (for example, regarding interest rates or inflation).

When each private party's financial models are reviewed as part of the competitive bidding process, it will reveal the genuine differences between parties. It will also reveal how sensitive the RFP responses are to external factors, such as interest rate changes. In order to ensure consistency when making comparisons between parties' bids, the procuring authority will make certain assumptions regarding, for example, rates of interest and exchange rates such that it will assume the rates are the same for each party's bid.

While the financial model is produced by the consortium as part of its response to the RFP, it will continue to be adjusted to reflect the financial consequences of any PPP project changes agreed with the procuring authority during the bidding process and throughout the term of the PPP project.

**BOX 6A.2: Financial Advisers' Activities**

- Developing the financial model.
- Identifying financing structures.
- Identifying sources of finance, including grants.
- Negotiating with funders.
- Advising on the Project Information Memorandum (PIM) and other financial terms, such as ratios and financial covenants.
- Fundraising and managing the funding competition.
- Project risk assessment.
- Reviewing the payment mechanism.

**6.7.2.2 Funders to the PPP Project and the Types of Funds they Provide**

The financial structure of a PPP project, as in any project financing, requires the provision of debt and equity. Debt and equity can be provided by a number of entities, and they are normally provided at the point where the consortium changes its status and incorporates into the SPV. It should be noted too that the capital markets can be used to raise debt funding.

The sponsors will inject equity into the PPP project by becoming shareholders in the SPV. They will have an equity stake in the SPV. Additionally, they may provide subordinated debt, especially if this ensures a favorable treatment for taxation purposes. International and domestic commercial banks will be the usual funders to the PPP project unless a project bond structure is developed (see below). Multilateral institutions such as the World Bank, through the International Finance Company (IFC), the European Investment Bank (EIB), the Asian Development Bank (ADB), the African Development Bank (AfDB), and the European Bank for Reconstruction and Development (EBRD) may also provide a source of project finance. Export credit agencies can also be a funding source.

Other potential debt providers are debt funds, sovereign wealth funds, and pension funds. Such providers may provide equity.<sup>23</sup> The optimal mix of funding sources will be dependent on their availability for a particular PPP

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<sup>23</sup> In some countries, the equity providers may be allowed to transfer their shares early on (for example, before the construction works start). In such a case, it is not uncommon for sponsors to pre-agree with an investor on the disposal and transfer of a percentage of their equity shares to the investor. This means that the equity investor would become an equity participant in the PPP project at the same time as financial close. In other countries, however, all equity investors will have to be part of the bidding consortium from the beginning in order to be allowed to invest in equity. If this is not the case, then the investor will only be able to become an equity investor after the construction works are completed.

project in a specific market, as well as the overall cost of funding for the PPP project. See box 6A.3.

***BOX 6A.3: Examples of Entities that may Act as Project Funders***

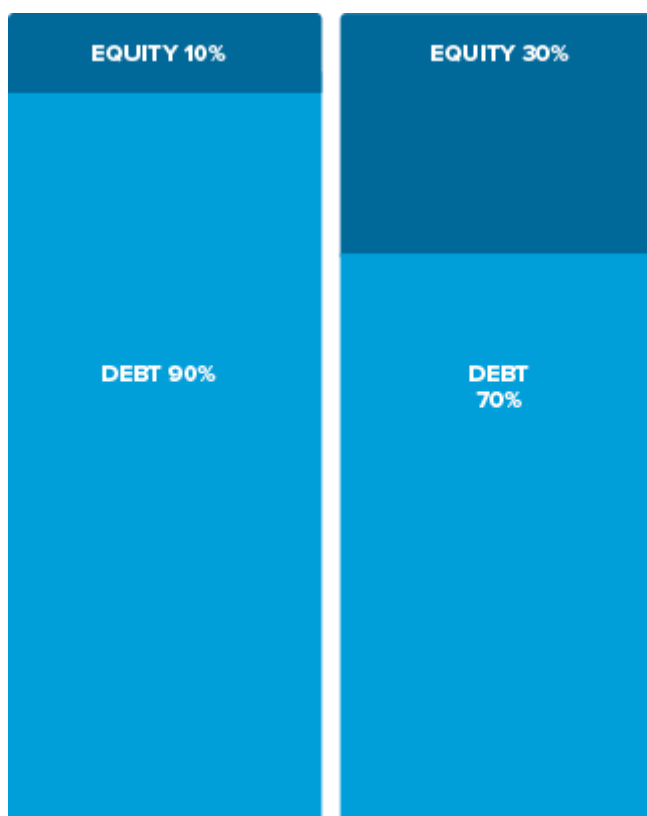
- Banks – domestic and international.
- Project sponsors.
- Infrastructure funds.
- Multilateral institutions.
- Sovereign wealth funds.
- Pension funds.

The main features of the debt and equity elements of a PPP project's financial structure are set out below.

***Debt***

Most PPP projects receive debt financing from banks. Debt financing is normally the cheapest form of project finance. Bank financing normally results in a bank lending, for example, 70–90 percent of the monies required to fund the PPP project, with the balance of 10–30 percent coming from equity providers. The amount of debt provided to a PPP project as a percentage of its total funding requirement is known as its gearing. In respect of the above examples the gearing is 90–70 percent, and the split of debt and equity sources of finance is represented by the ratio 90:10/80:20/70:30 respectively. It should be noted that a PPP project's gearing depends on the risks attached to the specific PPP project, with certain project sectors receiving a lower proportion of the debt than others. See figure 6A.13.

*FIGURE 6A.13: Capital Structures: Equity/Debt*



The cost or price of debt is normally the underlying cost of funds to the funder plus its margin and the associated fees. The margin is the additional funder's costs to cover the risk of the SPV's loan default and the costs of putting in place the loan itself.

The underlying cost of funds is determined on the basis of floating/fluctuating interest rates. The cost of lending money over 20–30 years, the typical length of a PPP project, will not remain constant. However, the PPP project cash flows will generally be constant. This means that there is a mismatch between the *constant/steady state* revenues that the SPV receives under the PPP project — and the ever changing interest rates that apply to the underlying costs of funds borrowed.

This issue is addressed by the SPV taking out a financial product to pay a fixed amount of interest for the funds borrowed. This financial product is known as an interest rate swap and it will be purchased at financial close.

### ***Debt repayment***

Debt is repaid over the lifetime of a PPP project. The debt payment profile will be set out in the funding agreements and will be determined at financial close. Normally, debt will be fully paid off before the PPP project term ends, leaving



a period of time when all monies coming into the PPP project will be paid out to the equity providers.

### ***Funding contingencies***

It is not unusual, although it is undesirable, for a PPP project to face unforeseen financial liabilities such as cost overruns. When this happens, funds need to be found to make payment. The monies required are known as contingency funding. The amount of contingency funding will be set out in the financial model.

### ***Currency for borrowing***

Although there is no correct practice, borrowed funds will normally be in the local currency used to make payment to the SPV. Should the local currency be particularly volatile, then the procuring authority may find that the SPV will charge a higher cost of funding because of the increased risk of the PPP project revenues being devalued.

The currency of capital outlays and the availability of funds from local markets will also affect the cost of funding. The procuring authority, in a “government-pays” project, may therefore find it beneficial to make payment in US dollars or pounds sterling. These currencies are stable and payment in them will be attractive to the SPV because it will help mitigate its currency risk.

### ***Equity***

Different types of investors can provide equity. These include infrastructure funds, third party investors, and construction and O&M companies. Equity is injected through the acquisition of share capital by individual shareholders. When equity is provided, the equity provider will acquire shares in the SPV and be classified as a shareholder.

Payment of equity, known as a dividend, normally occurs after the PPP project’s debt (including subordinated debt<sup>24</sup>) has been paid, so it happens late in a PPP project’s term. This means that it is most at risk. Should there be insufficient PPP project revenues generated because of poor performance of a PPP project, then it may not get paid out. As it is most at risk, and its payment is deferred, the equity providers will expect a much higher return for the monies they have lent. It is more expensive than debt.

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<sup>24</sup> The benefit of subordinated debt is that it can be repaid throughout the term of the project at an agreed fixed rate of interest and provides the sponsors an additional return.

### ***Use of the capital markets***

Bond financing of PPP projects is not the prevailing source of finance. However, it provides an alternative funding instrument that the SPV can access through the capital markets. Specifically, it provides long-term finance for the PPP project which can complement the debt provided by the funders. However, bonds are less flexible than bank debt.

The process of carrying out a bond issue varies from country to country. If a bond is going to be issued, then it will be necessary to obtain local financial and legal advice so that a robust commercial, financial, and legal due diligence can be carried out on the project and the procurement process.

For any bond issue, it is a prerequisite that there be an appropriate risk allocation between the PPP project parties. Additionally, each of the PPP project parties must have a strong covenant that is supported by different types of security. In practice, this means that the approach to these issues, as evidenced above in the case of a debt financing, is broadly similar.

There are a number of stages that a bond issue goes through and these can be summarized as follows.

- Pre-launch – deciding the type of bonds to issue, their value and terms;
- Road show – marketing the prospective bond launch so as to attract investors who will buy the bonds; and
- Bond issue – issue of bonds to investors and the payment of funds.

Bond issues can take a short or a long period of time to put in place. It will depend on the country where the bonds are being launched and the project sector, as some sectors are more attractive than others.

### ***6.7.3 The Legal Solution: Review and Drafting of Legal Documentation***

The consortium's legal team will be made up of internal and external legal advisers. It will have a number of tasks to complete.

Some tasks will need to be completed as part of the PPP project screening process. Activities required at this stage include carrying out an assessment of the key legal requirements that are already established (for example, it may be known early on that there is a requirement for the SPV to have the procuring authority as a shareholder), and reviewing the legal impact of the allocation of PPP project risks.

Other tasks will be completed as part of the bid preparation process. The legal team will have to work with the consortium's commercial, technical, and financial teams to ensure that their different solutions that form part of the RFP proposal can have legal effect. This means that there will need to be a review and assessment of the legal issues arising out of the project agreement, and the consortium will need to be advised of the conclusions.

The legal team will also have a role in considering the legal aspects of the procuring authority's funding requirements. For example, the procuring authority may request that the PPP project is bond financed, and in this situation the legal team would advise on the financial, regulatory, and legal compliance requirements.

It may be possible to amend the project agreement (if this is permissible it will be stated on the PPP project tender documentation), and if so then this is a task that the legal team will carry out at this stage.

The legal team may also be required to carry out legal due diligence to assess the legal powers of the procuring authority to carry out the PPP project procurement. It may also carry out due diligence on the legal and regulatory framework of the PPP project.

As part of the bid preparation process, the legal team will need to put together the package of legal documents required for the RFP response. There are different practices worldwide. Some countries require that all the key PPP project contracts are drafted, agreed, and submitted as part of the legal package. This would include the construction and O&M contracts, the agreements that create the SPV, and in some cases the funding documents.

Other countries do not require such a detailed response and accept heads of terms (a summary of the key terms to be included in the contracts – see below) for each of the key contracts at the point when the RFP response is submitted. When this happens, however, the legal team will be required to draft and agree to all the key contracts at a later time during the period from the appointment of the preferred bidder to financial close.

Some legal tasks will be ongoing ones and will be carried out throughout the PPP project procurement. Such tasks include negotiating with the procuring authority, the funders, and the consortium's supply chain contractors.

In summary, the legal team will have the following key tasks.

1. To review the legal aspects of the RFP, including the project agreement, to interact with the procuring authority and to prepare the package of legal documents that form part of the consortium's RFP response;
2. To prepare the agreements necessary to set up the SPV (its constitutional documents); draft the heads of terms for the construction and O&M contracts; and draft, negotiate, and finalize the construction and O&M contracts; and
3. To review the funders' finance documents and draft the associated legal documents, to participate in the general commercial negotiations, and to support the fundraising negotiations.

***1. Reviewing the legal aspects of the RFP, interacting with the procuring authority, and preparing the package of legal documents that are a requirement of the RFP***

The legal documents issued as part of the procuring authority's RFP will include the project agreement, the direct agreement, details of the required insurances, and the bid bond and required security. On occasion, the procuring authority may provide or specify the forms of security it requires to provide an assurance that the SPV will deliver the PPP project as required. For example, the procuring authority may require a Parent Company Guarantee from the construction contractor that will guarantee the proper performance of the construction works.

The consortium's legal team will consider the legal documentation provided by the procuring authority. The team will highlight the key obligations and responsibilities the procuring authority requires the SPV to assume.

The legal team, together with the consortium's advisers, will also advise on the risk allocation inherent in the legal documentation and its acceptability. Using this information, the consortium will be able to make an assessment of the obligations and risks that can and cannot be accepted.

During the course of the PPP project procurement and/or during the bid submission period, the consortium will, through its legal advisers, let the procuring authority know its view of the terms of the legal documents. It will do this in writing, at meetings, or through a combination of both throughout the bidding process.

The key terms within the procuring authority's provided documentation that the legal advisers consider can be found in table 6A.1.

TABLE 6A.1: Key terms within the legal documents provided by the Authority

<b><u>Project Agreement</u></b>	<b><u>Authority Direct Agreement</u></b>	<b><u>Insurance</u></b>	<b><u>Bid Bond and Security</u></b>
SPV's obligations and responsibilities Construction matters O&M issues Payment and financial matters The effect of changes in law Force majeure, delay events and relief events Termination, including event of SPV or authority default Sub-contracting arrangements Dispute resolution procedure	Step-in rights	Required insurances, including Construction All Risks, Business Interruption, Advance Loss of Profits, Third Party Liability, and general project-specific insurances.	Quantum of bond Bond duration On demand nature Scope of the parent company guarantee

Note: O&M= operation and maintenance; SPV= special purpose vehicle.

The legal team will be responsible for checking that all the RFP requirements are met, and that the consortium's RFP response is compliant.

***2. Preparing the agreements necessary to set up the SPV (its constitutional documents); drafting the heads of terms for the construction and O&M contracts; and drafting, negotiating, and finalizing the construction and O&M contracts***

The key legal agreements that need to be prepared are as follows.

- **SPV constitutional documents**

The consortium's legal advisers will spend a significant amount of time establishing the SPV, for which the following is required.

**SPV formation checklist**

- Identify the SPV's name;
- Identify the SPV's address;
- Specify the number, name, and address of directors;
- Specify the names and addresses of the shareholders;
- Determine the size of each shareholder's share allocation, including the share types and value;
- Enter into a memorandum of association, that is, an agreement to form the SPV;
- Agree to the rules that govern how the SPV will operate (the articles of association);
- Prepare a statement of capital; and
- Draft and agree on the shareholders' agreement.

In most cases, the formation of the SPV does not require the involvement of the procuring authority. There may, on rare occasions however, be a requirement for the procuring authority to be a shareholder in the SPV. It will also be prudent for the procuring authority to carry out checks in some key areas. For example, some procuring authorities require the SPV to be incorporated in the country where the PPP project will be carried out; and some also apply restrictions on the age and qualifications of those who can be appointed as SPV directors.

- **Shareholders' agreement**

One of the key tasks for the consortium's legal team will be to draft the shareholders' agreement. As noted, the shareholders will be the project sponsors. The shareholders' agreement needs to address, among other things, the following key issues in table 6A.2.

TABLE 6A.2: Shareholders' Agreement Requirements

<b><i>SPV Board Representation and Voting Issues</i></b>	Composition of the SPV board; number of directors and their voting rights; inclusion of a chair of the SPV board (or not); format of board meetings; decision-making and how to deal with deadlock between directors and disputes.
<b><i>SPV Governance</i></b>	Regularity of meetings; approach to conflict of interests.
<b><i>Budgeting and Dividend Distribution Policy</i></b>	Developing and implementing the SPV's annual financial plan; implementing the dividend distributions policy, and developing and approving changes to it.
<b><i>Selling Shares and Shareholder Exit Process</i></b>	Development of shareholders' rights to purchase shares before any other party has the opportunity to purchase them (pre-emption rights); the timing and the process to be adopted for shareholder exit, and the scope of the indemnities to be provided to the remaining shareholders.
<b><i>SPV's Daily Activities and Management</i></b>	Identification of the work the SPV will carry out; its method of working; and its operational management structure.

- **Heads of terms**

The consortium's legal team will initially assist in the preparation of heads of terms (HOTs) for the construction and O&M contracts which are entered into between the consortium and the construction and O&M contractors. Although not binding, the HOTs will set out, in summary, the key commercial areas that the consortium and the construction and O&M contractors expect to be included in their contracts. Specifically, they will set out the degree of acceptance that can be given to the project agreement obligations that will then need to be passed through to the contractors. The HOTs will be developed throughout the bidding process, and will

eventually form the basis of the construction and O&M contracts that will also be prepared by the legal advisers.

- ***Construction and O&M contracts***

The construction contract may be based on international standard forms, such as those promoted by the International Federation of Consulting Engineers (FIDIC). If so, then the consortium's legal team will amend the standard form to ensure that it contains a full pass through of the construction obligations contained in the project agreement. It will also include additional requirements that the SPV will expect its contractors to comply with (for example, the requirement to provide a performance bond for completion of the construction work). These additional requirements will sit alongside the typical contractual requirements found in such contracts, such as the requirements for a fixed construction price, a fixed completion date, and the payment of milestone payments on completion of fixed packages of construction works.

If a bespoke construction contract is used, such as a "design and build" (D&B), instead of an international standard form, then the consortium's legal advisers will draft it so that it will mirror the form and content of the project agreement. It will also contain a direct pass through of its obligations (see below). In addition, it will reflect the commercial agreement between parties regarding price, lump sum payment, milestones, and the construction completion process.

Unlike construction contracts, O&M contracts are not based on standard forms and so will be bespoke in nature according to the procuring authority's PPP project. In this respect, the drafting of the O&M contract will be carried out in a similar way to the drafting of a bespoke construction contract. The O&M contract will mirror the form and content of the project agreement, and will contain a pass through of the project agreement's obligations to the O&M contractor. The O&M contract will contain additional commercial terms, such as a yearly price with a formula for inflating it on a yearly basis and life-cycle obligations.

The construction and O&M contracts written by the consortium's legal team will contain a number of key terms, as outlined in boxes 6A.4 and 6A.5.



**BOX 6A.4: Key Sections in the Construction Contract**

- Design and construction process.
- Commissioning.
- Role and responsibilities of the independent tester.
- Construction completion certification.
- Snagging matters
- Latent defects.
- Performance bonds.
- Parent company guarantees.
- Insurance.

**BOX 6A.5: Key Sections in the O&M Contract**

- Services scope and requirements and impact of non-compliance.
- Maintenance scope and requirements and impact of non-compliance.
- Monitoring of performance.
- Poor performance and its consequences.
- Termination of poorly performing operator.
- Staffing and employment rights and responsibilities
- Parent company guarantees.
- Insurance.

***Pass through of obligations and risks***

The consortium's legal team will ensure that there is a direct pass through of the project agreement obligations into the construction and O&M contracts. In practice, this means that the consortium's legal advisers will ensure that each of the construction and O&M obligations contained in the project agreement are extracted and used to form the basis of the construction and O&M contracts, respectively. Typically, in terms of documentation this might look like the following example in box 6A.6.

**BOX 6A.6: Pass through of PPP Project Obligations****Project agreement term – construction**

“The SPV shall complete all the construction works necessary to provide the PPP facility.”

**Construction contract term**

“The construction contractor shall construct the PPP facility for a fixed sum.”

**Project agreement term – O&M**

“The SPV shall provide the procuring authority with the O&M services.”

**O&M contract term**

“Following completion of the construction of the PPP facility, the O&M contractor shall provide the O&M services to the SPV in accordance with the terms of this O&M contract.”

The approach to the pass through of the project agreement’s risks is illustrated as follows in table 6A.3.

TABLE 6A.3: Project Agreement Risks

<b>Project Risk/Obligation</b>	<b>Agreement</b>	<b>Pass Through Treatment</b>
SPV responsible for cost overruns and construction delay		Risks of price and time to be borne by the construction contractor through the construction contract requiring construction works to be completed for a pre-agreed fixed lump sum and by the completion date prescribed in the project agreement.
Performance and service deductions		Poor performance deductions under the project agreement recovered by the SPV through the operation of the construction and O&M contracts. These provide for the contractors to compensate the SPV and make payment to it for poor performance. Liability of contractors to the SPV will be capped however, and shortfalls will need to be met by insurance or SPV’s reserves.
Construction defects		Construction contractor liable to meet the cost of remedying defects by assuming liability under the construction contract.
Life cycle		The O&M contractor is liable under the

	O&M contract to meet the cost of ongoing maintenance and life cycle. Receives regular payments from the SPV managed life-cycle fund to carry these out. Failure to carry out life cycle and maintenance may result in monies being withheld.
Termination and replacement of sub-contractors	Poorly performing sub-contractors can be terminated and replaced by the SPV. The construction and O&M contracts provide for the SPV to be compensated if a replacement sub-contractor is required.
Land acquisition/planning and other consents	May be retained by the procuring authority. Alternatively, may be retained by the SPV or be the responsibility of the construction contractor under the construction contract. Where retained by the procuring authority or the SPV, the construction works will not normally commence until the land and consents are acquired.
Site and soil conditions	Risk is passed to the construction contractor under the construction contract.
Environmental matters	Risk is passed to the construction contractor under the construction contract, and to the O&M contractor under the O&M contract.
Strikes and protester action	Risk is passed to the construction and O&M contractors under their contracts.
Change in Law	Risk is retained by the procuring authority where it is discriminatory or project specific. Risk of general changes of law is passed through to the construction and O&M contractors under their contracts.

The consortium's legal team will also need to consider and advise on the interface issues that exist between the contractors. An example of such an issue is delay. Should the construction program be delayed, then the O&M period will normally be reduced because of the effect of the fixed PPP project term that means the operational period cannot be extended by the length of the construction delay. A shorter O&M period means that there will be less revenue available for the O&M contractor. The O&M contractor, as it is not responsible for the construction delay, will wish to ensure that it receives compensation from the construction contractor to

cover its loss. However, the O&M contractor has no direct contractual right to sue the construction contractor for this loss. There is therefore the need to create a direct contractual relationship between the O&M contractor and the construction contractor. This is done through an interface agreement. It is the interface agreement that creates the contractual rights between the contractors, and it gives each a right to sue and be compensated by the other, should this be required.

### ***3. Reviewing the funders' finance documents, drafting the associated legal documents, participating in the general commercial project negotiations, and supporting the fundraising negotiations***

PPP projects necessitate the completion of a significant amount of funding documentation. The consortium's legal team will work closely with its financial team to ensure that the funding agreements are negotiated robustly with the lending institutions, and that they accurately reflect the agreement reached between the parties. As with all of the contractual documents, the legal team will work with the sponsors to ensure that the terms and conditions of the funding documents are acceptable.

## **6.8 Fundraising**

### ***6.8.1 Negotiating with Banks***

The consortium's financial advisory team prepares the Project Information Memorandum (PIM). The PIM sets out details of the PPP project, including the anticipated key contracts and projected revenues. Assuming a financing competition, a group of funders will be asked to compete against each other to fund the PPP project. They will then submit their responses to the financial advisers. These will be assessed and a winner picked. That winner will become the PPP project's funder. This practice is normally known as a funding competition.

The assumption made is that fully committed financing will not be required while the consortium is bidding for the PPP project. Rather, it is assumed that fully-committed financing will only be required once the consortium has been selected as the preferred bidder for the PPP project. In this situation, it is normal for the detailed funding arrangements to be put in place during the period between the appointment of preferred bidder and the close of the PPP project. However, in such cases, during bid preparation and before bid submission, the main terms of the project financing will have to be negotiated and agreed, or at least defined as a detailed "term sheet"

under an indicative proposal. This is because the consortium needs to be confident that a project funder is satisfied with its RFP proposal.

The consortium needs to know the basis on which a funder will provide support to the PPP project. Ideally, this needs to be known prior to submission of the RFP response because the cost of finance will drive the overall cost of that response. It will be problematical if the consortium only gets its financing terms agreed after it has submitted its RFP response because the funder may make it a condition of funding that the terms of the consortium's RFP have to change. However, if the RFP response has already been accepted by the procuring authority, then changing the RFP response will be difficult to achieve.

It should be noted that it is possible for the lender that has won the funding competition to be a sole bank or a group of banks, known as a "club" (or "syndicate"). The successful lender will enter into a mandate letter with the sponsors setting out the terms of the loan; these terms will form the basis of the finance documentation that is entered into at a later stage.

It will take a period of time to agree to the terms of the PPP project's funding documents<sup>25</sup>. The funder will need to be satisfied that its investment in the PPP project, through the provision of funds, is suitably protected. The funder will want to ensure too that the PPP project risk allocation will minimize any chance of project default occurring.

### **6.8.2 Banks' Approach to Risk**

As well as ensuring that there has been a robust approach to risk allocation, the funders will want to ensure that the PPP project is structured in such a way as to give them an acceptable level of risk protection. Typically, the banks will require full disclosure of all PPP project information and data so that they can conduct their own due diligence to understand the PPP project risks and, ultimately, fix their lending rates and fees.

Some of the key ways the SPV will protect itself is through its limited liability, and by passing through the risks contained in the project agreement to the construction and O&M contractors. It will also expect these contractors to provide it with guarantees from their parent companies. These parent company guarantees (PCGs) will ensure that if the contractors fail to carry out their contractual obligations, then the parent

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<sup>25</sup> Funding documents will not be finalized until all commercial elements of the project have been agreed. Consequently, the procurement timetable should factor in a number of additional weeks after the commercial agreement for concluding the finance documents.

companies will assume responsibility for the obligations and/or provide financial compensation to the SPV to cover the cost of the failure.

The funders will also adopt a series of key approaches to protect themselves against the adverse effect of the PPP project's risks. They will want to ensure that the passing through of risks into the construction and O&M contracts is appropriate. The funders will therefore scrutinize the passing down of obligations as part of their due diligence. They will expect to see the allocation of risk as per table 6A.3 in section 6.7.3.

Additionally the funders will want to ensure the guarantee of equity/ subordinated debt subscriptions and the subordination of all other debt. The funders will also require a right of step-in to a failing PPP project to help ensure it gets 'back on track' in terms of performance. The step-in rights are set out in the "direct agreement" that is entered into with the procuring authority, SPV, and the funders.

### ***6.8.3 Finance Documents and Their Review***

The key financing documents are those that govern the terms of the funding provided to the SPV and the security for the money lent. The key document is the credit or loan agreement that sets out the types of funds that the funders will provide to the SPV. The funds, although provided under one loan agreement, will actually contain a number of "ring-fenced" amounts, known as "facilities" that can only be used for their agreed purpose.

The credit agreement is a baseline facility that will provide the SPV with funds to meet the costs of construction and other pre-agreed costs that arise during the construction period when the PPP project is not yet generating revenue.

The credit agreement will also include other facilities to be used as working capital to cover the costs of implementing changes in law, or to meet life-cycle and maintenance costs.

Like any other domestic loan, the credit agreement will set out how and when money can be borrowed (that is, the draw-down requirements), and how and when it has to be paid (that is, the loan repayment formula or repayment schedule). Typically, the repayment of the PPP project debt will take place over the life of the PPP project on a reducing basis. Usually the repayment schedule follows the PPP project's cash flow projections.

The funders will also require the credit agreement to contain measures to ensure the financial robustness of the PPP project on an ongoing basis. These measures are known as the financial ratios, and they should not be breached by the SPV. Ratios

are normally calculated and checked by the funders and the SPV every 6 months. The two most common ratios that will have to be met are as follows.

- **Loan Life Cover Ratio (LLCR)** – this is used to measure the ability of the SPV to pay back the funds. At any given point it compares the project's projected Net Present Value (NPV) of the cash flow available for debt repayment and the amount of project debt remaining; and
- **Annual Debt Service Cover Ratio (ADSCR)** – this is used to compare the past 12 months of the project's Net Present Value (NPV) of the cash flow for debt repayment and the amount of debt repaid (principal and interests) during the same period, as well as the projected cash levels for the coming 12 months to the amount of debt due to be repaid.<sup>26</sup>

The finance documents will also include the security package that the funders take as their security for lending to the SPV. See box 6A.7. The security deed sets out what security the funders have taken over the PPP project revenues and assets. The funders will want to have the right to protect their interests in the PPP project, especially if the PPP project gets into trouble. Therefore, the funders will enter into direct agreements with the SPV and the construction and O&M contractors; this is so they can step into these contracts and take over the running and role of the SPV should the PPP project get into difficulty. Once the funders have got the project back on track they will then step-out and the PPP project will continue to run with the SPV in control.

<b>BOX 6A.7: Funding Documents</b>			
<b>Finance Document</b>	<b>Purpose</b>	<b>Key Terms within the Document</b>	<b>Meaning of Key Terms</b>
Credit Agreement	To provide funds to finance the PPP project. It will contain the terms and conditions governing the provision of the funds.	Amount lent to the SPV	Monies used to finance the project.
		Price/Fee	Costs of funds, including the margin.
		Draw-down requirements	Dates for receiving funds from the lender.

<sup>26</sup> The value of the required ADSCR will depend on project risk and the variability of cash flows. If the SPV does not take demand risk, the minimum ADSCR would typically be: c. 1.2x -1.3x. However if the SPV accepts large demand risk, a minimum ADSCR c. 2.0x would be required.

		Loan repayment profile	Period over which the borrowed money has to be repaid.
		Representations and warranties	Assurances given by the SPV as a precondition of receiving the funds.
		Covenants	Assurances given by the SPV that it will conduct itself in a way agreed by the funders.
		Financial covenants/ratios	Measures to ensure financial robustness.
		Default events	Circumstances that can lead to the project agreement terminating.
Security Deed	Sets out the security taken by the senior funders for lending money to the SPV. As such it will necessarily supplement the Credit Agreement.	Security is taken over all of the project's documents and assets including:	
		Project contracts	This includes the project agreement, construction and O&M contracts.
		Project accounts	Contains the revenues generated from the project and the monies that have been received by the SPV, including all the facilities monies, the amounts sitting in the insurance proceeds account, and the maintenance and life-cycle reserves.



		Project's physical assets	For example, the PPP facility, SPV machinery.
		Intangible project assets	For example, the SPV-owned logos, intellectual property, patents generated as part of the PPP project, goodwill and so on.
		SPV's shares	Shares held in the project vehicle; normally held by the sponsors and material investors in the PPP project.
		Third party guarantees	Includes PCGs and other support to the project provided by third parties.
Inter-creditor Agreement	Agreement to regulate the relationship between co-funders		Terms regulate the rights and obligations of co-funders.
Direct Agreements	Agreement that enables the lender to step into a PPP project		Terms provide funder step-in rights, allowing them to take over the operation of key project contracts.
Project Account Agreement	Overarching agreement that sets out how the following project accounts will be operated: Debt service reserve account Proceeds account Lifecycle account Maintenance reserve account Compensation account		Terms regulate the use made of accounts containing project monies.

	Distributions account		
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*Note:* O&M= operation and maintenance; PCG= parent company guarantee; SPV= special purpose vehicle.

#### **6.8.4 Security Package, Taking Security**

The funder injects a significant amount of money into the PPP project, so it needs to protect itself and ensure that it will get paid back all of the money it has lent, together with the interest on the monies lent.

Full payment to the funder is predicated on the PPP project asset having been built and operated in a manner that generates sufficient revenue to make the debt repayment. To help ensure that, as far as is possible, this will happen in the future, the funder will, before lending, carry out due diligence on the PPP project to satisfy itself of the following conditions.

- The anticipated project cash flows are sufficient to pay off the debt;
- Payment to it will take priority over payment to any of the other funders; and
- There is additional support provided to protect it against any shortfall in the project's cash flows. For example, a parent company guarantee may be required from construction sub-contractors.

Similar to the formation of the SPV, although the procuring authority is not normally involved in the process of obtaining the PPP project funding, it will nevertheless be good practice for it to have an understanding of how the PPP project funding will work for a variety of reasons, including:

- To provide it with confidence that the consortium's proposed financing solution is viable. There will be no point in awarding the PPP project to a consortium that cannot get its proposal financed;
- To reveal how incentivized the senior funder is to ensure the success of the PPP project. The more debt borrowed, the greater this will be. Awareness of this should provide the procuring authority with a level of assurance that the PPP project will be delivered as anticipated; and
- To know a PPP project's gearing will help reveal how the PPP project will respond to future changes. The more debt in a project, the increased susceptibility to revenue fluctuations. For example, it is generally accepted that if there is a recession, then user-pay PPP project's revenues can decrease. Should this happen, there will be less money to pay off the debt. Knowing the effect of reducing revenues will help determine if there need to be changes in the finance solution to mitigate the effects of a future revenue shortfall. In practice, this might mean that a procuring authority's financial advisers will ask the consortium to review and further optimize the financial solution set out in its RFP response.

The funders will need to be satisfied that the projected PPP project cash flows are sufficient and secure enough to support the successful implementation of the PPP project and the re-payment of the money lent to the SPV. When "taking security" is

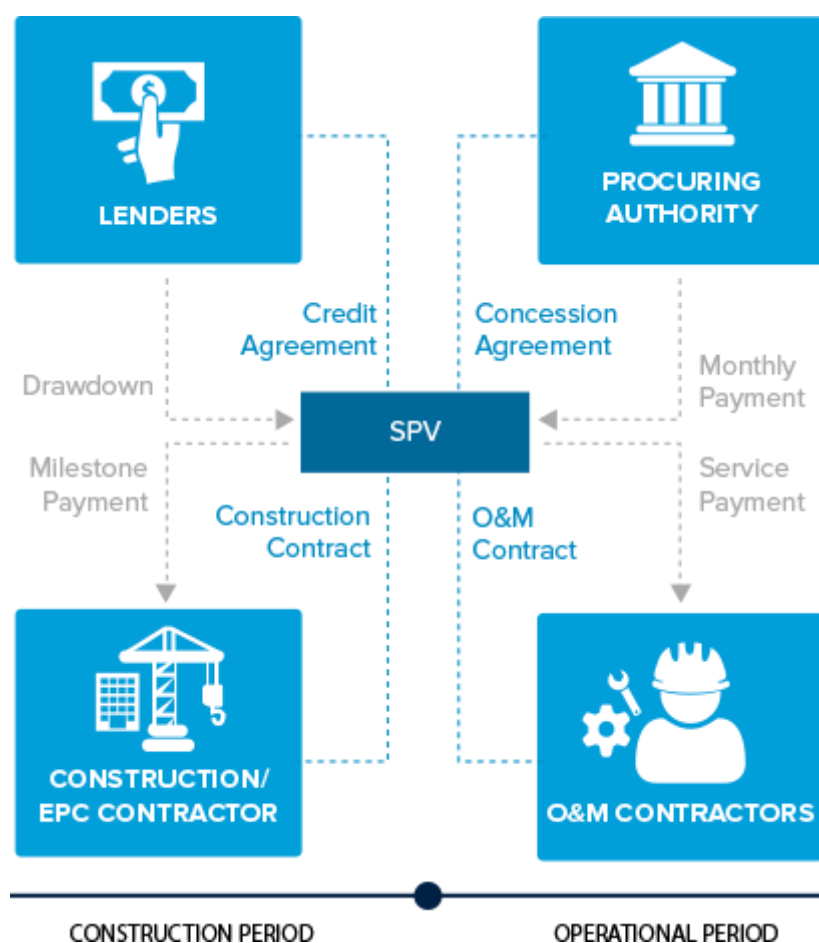
referred to in a PPP project financing, it means the extent to which the repayment obligation of the SPV is secured.

The funders focus on the potential cash flows of a PPP project because this is the main source for repaying the debt. During the PPP project's Construction Phase, no revenue will be generated because the procuring authority will not be receiving a service and so the rule, "no service, no fee" applies. Following completion of construction, however, the PPP asset will begin to generate revenue, whether that is through the provision of government or users' fees to the SPV.

#### 6.8.4.1 Project Revenues

The structure of the PPP project has been set out earlier. For the purposes of understanding the flow of monies between parties, in order to ensure a successful PPP project financing, the structure can be overlaid with the following arrangements as outlined in figure 6A.14 and box 6A.8.

*FIGURE: 6A.14: Money Flows between the Parties to a Project Financing*



<b>BOX 6A.8: Money Flows between Project Finance Agreements</b>	
<b>Agreement Name</b>	<b>Money Passing between Parties</b>
Project Agreement	Unitary charge payment from the procuring authority to the SPV.
Loan Agreement	SPV payment of debt service.
Senior debt interest and repayments	SPV payment of senior debt and interest to the senior funders.
Equity and subordinated debt	SPV payment of dividends and subordinated debt distributions.
Operation and Maintenance Agreement	Facilities management payment from SPV to O&M Contractor.
Facilities Management Sub-contract	Facilities Management Subcontractor payment from the O&M Contractor to the Facilities Management (FM) Sub-contractor.
Construction contract	Construction contract payment from SPV to the Construction Contractor (CC).
Construction Sub-contract	Construction Subcontract from the CC to the Construction Subcontractor.

Revenue generation is therefore a major source of debt repayment. As a result, the funders will take a keen interest in the financial model and the structure of the payment mechanism. This is because they are the key determinants of how likely the project will be able to meet its financial obligations.

The PPP project funders will conduct a series of sensitivities to ensure that the project's cash flow projections are subject to as little risk as possible. Funders will therefore perform the following tasks:

- Carry out due diligence on project running costs, and perform technical checks on costing and life-cycle assumptions;
- Check to ensure that the risks have been passed through from the SPV to the construction and O&M contractors and their sub-contractors;
- Identify ways of eliminating potential risks. For example, they may require the SPV to enter into a hedging agreement to offset the effect of interest rate fluctuations;

- Ensure the provision of adequate step-in rights;
- Require the inclusion of the funders' "permission to act" clauses in the loan documentation;
- Require the satisfaction of financial covenants in the loan agreements, including requirements to build up cash levels to meet debt service payments in advance of the payment becoming payable as well as retaining cash levels in excess of those required to service debt;
- Require cash retention for debt service and major works or operating costs;
- Check the assignment of the benefit of the contracts between the SPV and the procuring authority, including the income stream that the contracts will generate in the future; and
- Request that the procuring authority provide additional information and clarification on issues arising as part of the due diligence exercise.

#### **6.8.4.2 Main Forms of Security Documentation**

The main forms of security that the funders require in a PPP project include the following:

**Equity subscription agreement:** The funders will require seeing a minimum amount of equity provided by the sponsors, and the funders will take security over the SPV shares.

**Bank guarantees:** The bank will require security in the form of guarantees to be given in respect of the construction and O&M contracts. These guarantees are normally given to the SPV by the parent company of the relevant contractor. The guarantees cover the due diligence and proper performance of the contractor's obligations under the relevant contract. If the contractor fails to perform the obligations, then the parent company will perform or procure the performance of the obligations. The parent company will also indemnify the SPV for any losses or costs incurred as a result of the failure of the contractor to perform. The benefit of the guarantees are assigned to the bank, and if there is a default the bank can enforce the guarantees as appropriate.

**Parent company guarantees:** See bank guarantees above.

**Completion guarantees:** The SPV may be required to obtain from the construction contractor a guarantee that assures construction completion.

**Income and shortfall guarantees:** The SPV may be required to obtain an insurance type policy that pays out for loss of income.

**Pre-payment of loans:** The funders may require milestone payments of loans.

**Letters of comfort:** The funders may require the procuring authority to provide letters of support to the SPV, guaranteeing that the government-pays charge will be met.

**Fixed and floating charge/debentures:** The funders may take a debenture over the SPV as security for the senior debt. A debenture will charge all the property, assets, and SPV's undertakings in favor of the funders. The debenture will generally create fixed charges over all of the SPV's investments, land interests, plant and machinery, rights to insurance proceeds, book and other debts as well as the SPV's Intellectual Property Rights (IPR), monies and uncalled capital. The debenture will also create a floating charge over all of the SPV's assets that are not otherwise effectively mortgaged or charged under the fixed charges referred to above. The benefit of a fixed charge over specified assets is that it gives the funder priority over preferential creditors on enforcement. The benefit of a floating charge is that at crystallization the funder can block the appointment of an administrator over the SPV by appointing an administrative receiver.

**Step-in rights:** Such rights are normally contained in "direct agreements". Direct agreements are normally tri-partite and entered into between the procuring authority, the SPV, and the funder.

**Direct agreements:** The funders will have the right to step into a project contract and assume the rights and obligations of the SPV.

**Collateral warranties:** Under a collateral warranty, a party contracting with the SPV, such as a professional adviser (for example, an engineer or architect), will give certain undertakings and warranties directly to the funder. Typically, these would include the professional adviser accepting it owes a duty of care to the funder; and agreeing that the work it carries out will be "fit for purpose", will comply with accepted industry best practice; and that it will maintain a specified amount of insurance cover for a minimum period. The funders may require assignment/novation of these warranties.

**Insurance:** The bank will require the SPV to put in place certain project insurances, and these will be assigned by way of security to the bank. Such insurances will include insurance against physical damage or loss, third party liability, delay in startup and business interruption. As the insurances are assigned to the bank, the SPV is required to give notices of assignment to the insurer.

## **6.9 Commercial and Financial Close**

Commercial close means the point at which all the significant commercial issues between the procuring authority and the consortium have been agreed. However, at

the commercial close stage, it may be the case that the SPV still has to be formed or that the PPP project funding needs to be obtained or finalized. It is not necessary for commercial close and financial close to take place simultaneously, or indeed to occur in quick succession. Although these two scenarios are the most frequent in project financing, it can be the case that financial close will happen some months/years after commercial close.

A project is said to have reached financial close when all the project documentation has been signed, all the pre-conditions attached to the PPP project's financing have been met, and the PPP project funding becomes available. The flowing of the funds into the PPP project means that the SPV and its construction contractor can start to carry out the construction works to build the facility.

There are many pre-conditions, sometimes more than 100, that have to be met. The pre-conditions are referred to as “conditions precedent”. The conditions precedents have to be provided/met by the PPP project parties prior to triggering financial close. Generally they can be divided into 3 categories.

- **Procuring authority pre-conditions:** Provision of the procuring authority's consent to enter into the transaction;
- **SPV preconditions:** Formation of the SPV; provision of board minutes authorizing the entering into the PPP project; and provision of the required security from the SPV and its construction and O&M contractors; and
- **Lender preconditions:** Internal approval by its investment committee and entering into the funding swap.

Commercial close and financial close involve an intense period of activity for all parties as all the project commercial issues and documents need to be finalized. Final negotiations between the parties will take place, with the inevitable trade-offs being made on issues and costs.

The procuring authority will be responsible for preparing the project agreement. However, the balance of the project documentation — construction and O&M contracts, funding documents, and shareholder agreements (for details see the legal solution section above) — will be prepared by the private parties to the PPP project.