

# Contract Types

**This Section will explain, for each of the main project contracts or documents, the significance of the most relevant contract clauses.**

## Concession Contract

The concession contract entered into by the applicable administrative division or agency or entity of the host country, sometimes called the Grantor or Contracting Authority, and the project company concessionaire establishes the essential definition of the project's direction and provides the license for construction and/or operation and maintenance of the project. The contract should clearly define the scope of work (Module 2 -> Scope) of the concessionaire, what precisely he will be obliged and permitted to do and the length of time for which the concession is granted.

In the past, host governments have attempted to circumvent the legally binding nature of their obligations under concession agreements by invoking the doctrine of "sovereign immunity." International arbitration tribunals and courts have almost universally rejected sovereign immunity defences, however, on international legal grounds where stabilization or anti-nationalization or no material adverse governmental action clauses are included within the concession agreement. Such clauses act as a waiver of sovereign immunity.

Private parties to a concession contract, therefore, will want to protect themselves under international law against unilateral termination of the project or unilateral modification of a concession contract by a host government by including appropriate contract clauses, or by referring to the notion of administrative contracts where the host country's legal system considers a concession agreement as an administrative contract with the specific legal regime of rights and obligations attributed to such contracts.

A concession contract can take many forms, but the following is a list of typical provisions within such a contract:

- Project Completion and Timing
- Scope of Work
- Design
- Land use rights
- Environmental safeguards
- Material Adverse Governmental Action
- Pricing Formula
- Government Support
- Secondary Developments
- Currency Conversion, Availability, & Transferability
- Cross-Subsidization
- Non-Compete clauses
- Local requirements
- Compensation for Breach

### “Boiler Plate” Provisions

- Liability and indemnification
- Dispute Resolution
- Force Majeure
- Assignability/Sub-contracting
- Confidentiality
- Records and information sharing

## Construction Contract

Construction Contracts are simple in theory, but extremely difficult in practice: One actor, the contractor, agrees to construct the facilities of the highway for another actor, the employer, for agreed compensation by an agreed time. The variations of this simple statement and the ability to abuse bargaining position on both sides have led to various standard forms of construction contracts being developed by various participants in the construction world around the globe. The key issues relating to a construction contract for a toll road project include the following.

### *How will the construction framework be structured?*

The basic decision to make is whether to have one contractor responsible for all of the tasks : the design and the construction (a “turnkey” contract) or to have the individual contractors enter into separate contracts with the employer (whether the project company or the government) while having them subject to control by one overall project manager who enters into a project management agreement with the employer. While the turnkey contractor assumes the risk on the performance of the sub-contractors he employs to carry out certain tasks, projects with project managers typically force the employer to prove which individual contractor was responsible for the particular problem and pursue that contractor for damages. The advantage of this option is that the contractor will start the construction on a design that has been agreed by the project company and the host government, which offers some protection against subsequent diverging interpretations of such design or subsequent request for modifications of such design by the host government. However, the disadvantage is that of time, because this option will usually take much longer than a turnkey contract where the same contractor is responsible for both design and construction in one agreement. A third option is to have all the contracting companies form a construction consortium which enters into the construction contract with the employer with joint and several liability on the part of all its members. Variations and blends of all these structures are also possible.

### *Will there be a fixed price for the construction work?*

The price for the construction work is normally fixed to some degree, but what happens when there are cost overruns? A fixed price contract is the most efficient form of contract for the host government, but one which shifts all risk for cost overruns to the contractor. In order to more appropriately allocate risk, provision will be made in such contracts for additional payments to the contractor under certain circumstances, for example, changes in scope mandated by the other party, or necessary after an event of force

majeure payments may be geared to completion of milestones in the construction, but will almost always include an up front mobilization payment.

Other forms of contracts used for some aspects of construction on speculative or risky projects (e.g., wiring of a nuclear power plant) include unit price or cost plus contracts. These relieve the contractor of considerable risk resulting from cost overruns, and in the case of a cost plus contract, virtually assure the contractor of a fixed rate of return. These types of contracts are generally not favored for road construction, but elements of such contracts may be incorporated in a lump sum contract for a better allocation of risk.

*Is there a fixed time frame for completion and how is completion determined?*

Construction contracts often include a substantial completion date. An independent engineer may be involved to certify when substantial completion has been achieved. There may be a premium for prompt completion, or a penalty for delays, imposed by the contract.

- Project completion and timing
- Scope of Work
- Cost overruns
- Independent Engineer
- Environmental safeguards
- Land use rights
- Local requirements
- Quality Assurance
- Material Adverse Governmental Action
- Compensation for Breach

“Boiler Plate” Provisions

- Liability and Indemnification
- Dispute Resolution
- Force Majeure
- Assignability/Sub-contracting
- Confidentiality
- Records and Information sharing

**Operation and Maintenance Contract**

There are several ways in which the operation and maintenance (“O&M”) of a road project can be structured. When the scope of work of the project is limited to operation and/or maintenance, this task is entrusted to a contractor through a unique, typically 3-to-8-years contract. Operation and maintenance of toll roads are usually subject to the setting up of a Special Purpose Vehicle (SPV) made to isolate resources and expenses of the project. In this case:

- the SPV can conduct the O&M of the project itself
- the SPV can enter into an operation and maintenance agreement with an affiliated third party, e.g., one of its shareholders or affiliates

- the SPV can enter into an operation and maintenance agreement with an arm’s length third party; or
- the SPV can share the operating and maintenance role with a third party

The maintenance function can be separated from the operation function so that, for example, the maintenance role is performed by the construction contractor with the project company either retaining the operating role or contracting it out to a third party. The greater the number of parties performing the operating and maintenance function, the greater the risk of disputes about liability when something goes wrong.

There are advantages and disadvantages with each approach listed above (1)-(4). If an SPV intends to conduct the operation and maintenance role itself, it will need to have appropriate staff with appropriate experience and qualifications and oftentimes access to a wider pool of technical expertise through consultant agreements. If the SPV enters into an O&M contract with an affiliated third party, the O&M agreement tends to be less rigorous since the operator is incentivized to perform well since such performance will enhance the value of the shareholdings. An O&M contract entered into with an arms’-length third party would naturally be stricter and include provisions most importantly concerning the level of the third party’s operating and maintenance obligations and the standards he/she must adhere to, and those concerning the operator’s remuneration.

- Pricing Formula
- Project Completion and Timing
- Quality Assurance
- Currency Conversion, Availability, & Transferability
- Land use rights
- Local requirements
- Environmental safeguards
- Material Adverse Governmental Action

“Boiler Plate” Provisions

- Liability and Indemnification
- Dispute Resolution
- Force Majeure
- Assignability/Sub-contracting
- Confidentiality
- Records and Information sharing

## Management and Maintenance Contract

When a road agency entrusts a private firm with maintenance and operation of a road or part of a network, the contract can take three main forms:

In **quantity-based maintenance contracts**, works are normally defined by the Road Agency, either directly or with the assistance of a consulting firm (consultancy contract). The contractor is paid on the basis of unit prices for different work items. Contractual provisions are usually similar to those of construction contracts. Standards, bidding documents and forms of contracts have been developed by several international institutions such as the European Union or the World Bank (Standard Bidding Documents

for Works - SBDW). While this modality may be an improvement compared to force-account maintenance practices, the main problem of such an arrangement lies in the fact that the contractor has the wrong incentive, which is to carry out the maximum amount of works, in order to maximize its turnover and profits. It has often been observed that even if much work is carried out and much money is spent, the overall service quality for the Road User is below expected standards.

**Performance-based maintenance contracts** address the issue of inadequate incentives by fixing a monthly lump sum fee per km to be paid to the Contractor. It is important to understand that the contractors are not paid directly for physical works (which they will certainly have to carry out), but for the service of ensuring certain service quality criteria on the roads under contract. The remuneration paid to the contractor will implicitly cover all physical and non-physical services provided by it, except for emergency works. In order to be entitled to the monthly payment, the contractor must ensure that the roads under contract comply with the service quality levels which have been specified in the contract.

It is possible that during some months the contractor will have to carry out a rather large amount of physical works in order to comply with the required service levels, and very little work during other months. Yet his monthly payment remains the same as long as the required service levels are complied with.

One fundamental feature of the performance-based contract is that the contractor is entirely free to decide and carry out all actions he believes are necessary in order to comply with the service quality levels stated in the contract.

The service quality levels are defined from a Road User's perspective and may include factors such as average travel speeds, riding comfort, safety features, etc. If the service quality is not achieved in any given month, the payment for that month may be reduced or even suspended (Performance requirements in Operation & Maintenance contracts).

Under the performance-based contract, the contractor has a strong financial incentive to be efficient: In order to maximize profits, it must reduce his activity to the smallest possible volume of intelligently designed interventions, which nevertheless ensure that a pre-defined outcome (service level) is achieved and maintained over time.

This type of contract makes it necessary for the contractor to have a good management capacity. Here, "management" means the capability to define and optimize the physical interventions which are needed in the short, medium and long-term, in order to guarantee that the roads remain above the agreed service quality levels. In other words, the contractor is free and must be able to define by himself: (i) what to do, (ii) where to do it, (iii) how to do it, and (iv) when to do it. The role of the Road Administration or the Employer is limited to verifying whether the agreed service levels have been complied with.

### *Management contracts*

The scope of work entrusted to the private firm is sometimes more closely related to the organization of road maintenance operations than to the actual works. Usually, the function of the private firm is to respond to day-to-day routine maintenance requirements

by contracting private companies, on behalf of the public entity, to perform the works. In this case, the private firm is not necessarily a works contractor, but may be a higher-level engineering firm, which would subcontract all physical works to local works contractors.

### *Emergency works*

Some non-programmed emergency works may become necessary. They are meant to remedy unexpected and unforeseeable damage which occurs as a result of “force majeure” events, and which affect the normal use of the road network and the safety and security of the users. For emergency works, the contract limits the responsibility of the contractor, and a separate remuneration based on unit prices may apply, for which a certain percentage of the contract amount is normally set aside.

Following is a list of some typical provisions within such a contract:

- Scope of work
- Performance requirements
- Project Completion and Timing
- Quality Assurance
- Local requirements
- Environmental safeguards
- Material Adverse Governmental Action

### “Boiler Plate” Provisions

- Liability and Indemnification
- Dispute Resolution
- Force Majeure
- Assignability/Sub-contracting
- Confidentiality
- Records and Information sharing

## **Consultancy (service) Contracts**

Consultants are involved in several aspects of the PPP and at various stages of the development. In PPP projects, Consultancy contracts do not necessarily differ in structure or in content from those usually drafted for traditional projects and often based on standard service contracts provided by International Financing Institutions (IFI), FIDIC, or other agencies.

Consultancy contracts typically include boiler plate provisions such as:

- Liability and Indemnification
- Dispute Resolution
- Force Majeure
- Assignability/Sub-contracting
- Confidentiality
- Records and Information sharing