Stage 4: Contract Award

This section sets out Guidelines for negotiations and contract award, which include essential check lists for the government.

Negotiations with the Private Sector

Negotiation itself is a skill but these guidelines help the government's negotiating party to equip themselves in order to get the best possible deal.

The bases of negotiation will be:

- Experience, which will build up over time.
- The feasibility study which sets out the key parameters of the project including the business case and provides the basis for the RFP.
- The Bid Documents which set out the bidders' conformity (or otherwise) with the requirements of the RFP.

The main negotiating items can include:

- Land acquisition and costs
- Project investment costs
- Tariff
- Concession period
- Risk bearing/allocation
- Renegotiation options on specific items
- Other items specific to the particular project

It should be noted that key items in the RFP, especially technical standards and conformity to regulations, will be classified by the Government as being non-negotiable and bidders not meeting these terms will be disqualified as being non–responsive.

There remain a number of other items in the RFP which the bidder may not meet and which will form the basis of explanation, discussion and negotiation.

In general, the number of items to be negotiated should be minimized and a standard negotiation process might have only 2 or 3 areas listed above for negotiation.

Financial Closure

After the concession contract has been awarded, there are a number of steps involved in finalizing the contracting negotiations. The concessionaire (or developer) must negotiate and sign a series of contracts with the other project participants. The concessionaire objective in this final but critical stage of the BOT process is financial closure.

Financial closure means that the project's entire equity has been unconditionally committed, all loan documents have been signed, and disbursement of the loans can start without further problems.

However, definitions of financial close vary and more significantly, have had varied interpretation in different countries.

Many governments have signed contracts with the private sector with very loose definitions of financial close. A possibly even more problematic mistake is that contracts have weak or no sanctions against failure to reach financial close within a stipulated period, so that the private sector can hold up the implementation of projects for years.

The PPIAF definition of financial closure varies among types of private participation. For greenfield projects and concessions, financial closure is defined as the existence of a legally binding commitment of equity holders or debt financiers to provide or mobilize funding for the project. The funding must account for a significant part of the project cost, securing the construction of the facility. For management and lease contracts, a contract authorizing the commencement of management or lease service must exist. For divestitures, the equity holders must have a legally binding commitment to acquire the assets of the facility. The PPIAF Database includes only projects that have reached financial closure.

Risk Structure

In greenfield BOT projects, the concessionaire must enter into a series of contracts with suppliers, contractors, insurers, etc. and the following contracts may be needed:

- **Sponsor's agreement** (or shareholder agreement): between the sponsors or shareholders forming the special purpose company for the project.
- **Engineering, procurement, and construction agreement**: with the contractor in charge of the construction of the facilities and supply of equipment. Usually a lump sum turnkey contract.
- **Insurance agreements**: in which the terms and conditions of all required insurance policies (e.g. third party liability, business interruption, etc.) are specified.

The combination of the concession contract and all these contracts will define the risk structure of the project. These risk structures together with the cash flow of the project form the threshold whether this project can be financed by lenders.

Financial closure includes the commitment of equity and debt funds. From the sponsor's view, these are the different kinds of financing sources:

- **Equity**: funding from the sponsors' participation and other participants having active interest in the project as risk investment
- **Subordinate Debts and Preference Shares**: funding from investors who invest in like near-equity return papers without taking full risk of equity capital;
- **Debt**: funding from commercial bank loans

BOT projects are usually funded under Project Financing, which involves the funding of a project, based on its internal merits and revenue stream (also called limited or non-recourse financing). As the assets of an infrastructure company are of limited use to lenders (it is not practical to dismantle the facilities and sell the parts), the focus is mainly on the project's cash flow and the contractual arrangements making up the project's security package. Once the security package satisfies the lender's requirements then the Loan Agreement can be signed committing the debt funding of the project from commercial banks.

Security Package: It is common under Project Finance for the lenders to take security over the project assets so far as this is possible under the laws of the country where the assets are situated. However, lenders may find that the local legal system gives them rights and powers that fall short of their expectations and require a "security" package. As one example, the following documents may need to be entered into to create or record the required security interest:

- mortgages or fixed charges over land, buildings and other fixed assets;
- fixed and/or floating charges over movable assets, book debts and production/ work in progress;
- assignments of rights under underlying project documents, such as construction contracts,
- contractors' performance bonds, licenses and joint venture agreements;
- assignments of sales contracts e.g. "tolling" agreements;
- escrow accounts to control and, when necessary, retain cash flows relating to the project;
- assignments of long-term supply contracts and
- agreements for supplies of energy and raw materials;
- assignment of project management, technical assistance and consultancy agreements;
- pledge of shares of project company including charge over dividend rights; and
- notices, acknowledgments, endorsements, filings and "perfecting" the security created
- under the various charges and assignments.

Security here connotes the creation of rights that attach to the assets themselves, not merely claims enforceable against the owner of those assets. These rights give the security holder certain powers, most importantly:

- the ability to prevent disposal of the assets by the borrower or guarantor (owner) or the granting of interests to third parties; and
- the power to take possession of, to operate and/or to sell and realize assets ahead of other creditors and any liquidator.

Tolling agreements are types of sales contracts with guaranteed revenues for tolling services independent of traffic.

Concession Contract Adjustment: These considerations demonstrate the complexity of the situation after the award of concession. This complexity in an ever-changing environment might imply that the Government might need to make certain adjustments in the concession contract even after award of the concession in order to reach financial closure.-

The Role of Economic and Socio Economic Models in Road Management, PIARC 2003.

Competitive Selection of Private Partners and Use of Standard Bidding Documents. Cesar Queiroz, 2008

Contracts for Public-Private Partnership (PPP) Options. World Bank, 2008

Procurement in Privately Provided Infrastructure (Ppi) Projects Financed by The World Bank. Armando Ribeiro Araujo, 1998