

Annex 4

Concession Contract Guide

1 Introduction

The aim of a Concession Agreement is to create the best value for money in the provision of railway services. The Agreement seeks to balance the contributions of the public and private sectors so that public service obligations are met as economically as possible while maintaining acceptable service levels; these tasks are sometimes best undertaken by the private sector, with some government support. Drafting the contractual arrangement known as the Concession Agreement should be preceded by conducting a comprehensive feasibility study that includes legal due diligence and risk review, which can differ from country to country.

In contractual arrangements, a key difference between civil law and common law jurisdictions is judicial interpretation of agreements. Generally, in common law countries, the law assumes that parties have set out the specifics of their agreement in the contract. Therefore, under law, the contract means what it says. By contrast, civil code countries rely more on the provisions in the civil code, hence, contracts tend to be shorter because they do not need to repeat what is in the code. In addition they are interpreted on a purposive basis, namely, “What was the intent of each party?”

To a degree, if project finance is used, international lenders tend to demand comprehensive documentation rather than rely on judicial interpretation, or failing that, the results of arbitration. However, if lenders can rely on being fully paid out by the state in the event that an agreement is terminated, they may be less concerned but the state is considerably more exposed to residuary risk.

The public sector would be well advised to consider the following: (i) Should it recapture some benefit from refinancing arrangements that improve the equity return? (ii) Should it rely on a financial model to make adjustments under the Concession Agreement? (iii) How should it calculate compensation upon termination if a corporate finance structure is adopted instead of a project finance structure? Concession Agreements would then reflect the outcome of these decisions.

1.1 *Purpose of Concession Agreement*

The three main objectives of a Concession Agreement are the following:

- Promote an understanding of the main responsibilities and risks that are to be undertaken by the parties to the agreement;
- Specify service levels to be delivered by the private sector and the flow of payments between the parties without extended negotiations; and

- Establish a consistent approach and pricing among bidders during any competitive tendering procedure that follows the introduction of reforms.

1.2 Key Factors

This Guide does not purport to set out draft clauses, instead it seeks to point out many of the issues that will need to be considered when developing concession-type arrangements. As indicated in the Introduction, in Civil Law Jurisdiction, some of these issues may be addressed within the Civil Code and therefore would not need to be repeated in the Agreement, or where permitted, the Agreement may seek to deviate from the Civil Code and the wording should reflect that. Therefore the Guide addresses not only general issues that may arise in relation to concessions but also factors and situations that are particular to railways, and their potential impact on a Concession Agreement. Although some of these factors and situations are neither mandatory nor essential, they illustrate issues that ought to be considered in concession-type arrangements.

- Will the private sector party be a special-purpose vehicle? Initially, this might mean that the party uses its own contractors and their subcontractors to supply services on its behalf. Usually, a special-purpose vehicle is a company set up for a single purpose. After operations and maintenance costs are met, company revenues are used to pay off debt, pay interest on the debt, and pay a dividend on equity. The company may apply revenues towards increasing and/or improving assets used in connection with the concession, but would not be expected to acquire assets for any other purpose.
- Does the public sector intend to create both a Concessionaire and the executed Concession Agreement, followed by a competition to divest the concession company to the private sector (namely with the benefit of the Concession Agreement)?
- Will the public sector contracting party be a Ministry, a government agency, or a state-owned company, such as a railway holding company? If it is a Ministry, state guarantees will not be needed as they would be if the contracting party were a state-owned entity.
- Will the assets to be used for the concession be transferred to the Concessionaire or will the transfer include only the rights to use the assets? As a corollary, where only the rights to use are transferred, will any new assets developed by the Concessionaire be transferred immediately to the Authority, with a continuing right for the Concessionaire to use them?
- Will the concessioned railway assets be a subset of the host country's railway system? Will the railway, subject of the Concession Agreement, be used primarily for freight, or must the Concessionaire allow infrastructure access to rail passenger traffic?
- Will the Concession Agreement require some infrastructure development or refurbishment and some new equipment (New Upgrades) followed by a full operational phase during which the Full Service is provided?

- Will operational obligations start as soon as the concession term commences?
- Should any land development associated with the concession occur through an associated Property Development Agreement? The agreement would benefit the public sector through a share of the proceeds from development because, in most economies, commercial and other property markets significantly deviate from the infrastructure development cycle. A Property Development Agreement avoids the risk of failure to realize the full market value of development rights.
- Should the Ministry retain the right to revoke air rights or rescind access to land that is not essential to railways operation, without compensating the Concessionaire? If the Ministry retained this right, the Concessionaire could not exploit its monopoly position in lineal infrastructure, for example, in relation to creating crossings over or under the infrastructure.
- Will the New Upgrades be wholly or partly financed by limited-recourse debt, or leasing arrangements?
- Should Future Upgrade costs be covered by retentions from the Concessionaire's revenue stream, except and to the extent provided for in the Concession Agreement? When the Agreement is executed, Future Upgrades may be as yet unidentified and emerge only as the host country economy grows.
- Should any tariff increases be permitted before the New Upgrades have been completed?
- Should the Concession Agreement permit derogation in standards to reflect the existing state of infrastructure and equipment until the New Upgrades are completed?
- The Concession Agreement should set out a safety regime if state law does not provide a safety regime for railways. This regime may be superseded when a statutory regime is adopted in the host country. If state law does require a safety regime, is there a regulator or other independent party to supervise the regime? Investors and Lenders may be nervous if the regime is applied by the entity entering into the Concession Agreement. As indicated in the Toolkit, the eventual objective should be economic regulation if market forces prove an insufficient economic incentive, and safety regulation through an independent regulator. There is some advantage to a strong link between economic and safety regulation to ensure that the safety regulation does not stand in the way of 'the good' by enacting a safety requirement for 'the best', which might be commercially infeasible. For the purposes of the Guide, and illustrative purposes only, it is assumed that there is a Railway Safety Board within the host country's Transport Regulatory Commission.
- Will international third-party access be required as soon as the State has signed cross-border agreements with governments of adjacent countries?

- If there is to be third-party international access, would it be useful to adopt the working assumption for the Concessionaire that the treaty rules will follow a precedent? Would COTIF (Convention Internationale sur le Transport International Ferroviaire) be useful as a guideline to identify a future access regime?
- If Border Crossing Points must be expanded and updated as a Future Upgrade but are as yet unknown because they will depend upon treaties with adjacent states, should the state pay capital costs of Border Crossing Points?
- When will an environmental audit be carried out? Both public and private sectors should understand the status of pre-existing environmental conditions *before* the tendering process commences. The worst scenario would be if the environmental audit is carried out after concession rights are already granted and in effect.

The answers to these questions will be reflected in the Concession Agreement but any particular solution does not imply that a given structure, including a financial structure, is inherently preferable. The suitability of various structures, including trade-offs between cost, complexity, and risk, should contribute to overall public sector appraisal of any reform proposals and, if a concession option is adopted, any subsequent bidder's proposal. However the nature of the Concession Agreement is such that documentation will be reasonably comprehensive; if a simpler transaction is adopted then the approach can be simplified. This Guide aims to encourage users to consider all of the issues; it is not meant to be prescriptive.

The award of the Concession may arise from an unsolicited bid (although an unsolicited bid may not achieve the best outcome), or from competitive tendering. As indicated in Chapter 13, the process for tendering needs to be carefully considered to achieve the best value for money while encouraging private sector initiative. On simple projects it may be possible to send out a form of contract that is to be signed by each of the bidders; the winning bid is then countersigned by the public sector, which becomes the contract. For more complex matters greater flexibility will be required but negotiations should be avoided after final offers are received.

The Guide it is intended to provide users with a conceptual framework within which to consider the various issues, many of which are inter-related. Therefore, the conceptual framework includes the concession of infrastructure with a right to operate rail freight services. Passenger transport services are assumed to be permitted over the rail infrastructure, but the rail passenger service franchise would be dealt with separately (for the Railway Passenger Service Guide see Annex 5). However third-party access is required over the rail infrastructure. For examples of Railway Concession Agreements please refer to the PPP in Infrastructure Resource Center.¹⁵⁵

¹⁵⁵<http://web.worldbank.org/external/default/main?menuPK=4704603&pagePK=64861910&piPK=64861909&theSitePK=4817374>

2 The Guide

2.1 *Parties*

In this Guide the public sector entity granting concession rights is referred to as the ‘Authority’ and its counterpart as the ‘Concessionaire’, with the overall scheme referred to as the ‘Scheme’. The agreement entered into between the Authority and the Concessionaire is referred to as the ‘Agreement’. All those with a financial stake in the Project, other than trade creditors and providers of equity, are referred to as ‘Funders’. Accordingly, the term ‘funding’ refers to all types of financial interest in the Project, other than equity and trade creditors.

Note, in some jurisdictions the bidder may be a consortium and the concession company may be created immediately before or after the Concession Agreement is signed. If the concession company was created immediately after, then the Concession Agreement should provide for itself to be assigned or novated to the new company before the concession term becomes effective.

2.2 *Recitals/purpose*

The document format will, to a degree, reflect what is customary in the host country. These provisions will describe the Authority and its mandate, the proposed concession, and may include a brief description of the bidding procedure and outcome, namely the appointment of the Concessionaire.

2.3 *Definitions*

In some jurisdictions, legislation provides for definitions in and interpretation of contracts and other legal documents. To the extent that this is not provided for, the interpretation of expressions and the meaning of defined terms should be set out.

Definitions for Railway Guide

Affected Party means the Party adversely affected by a Force Majeure Event.

Agreement means the Concession Agreement between the Authority and the Concessionaire.

Authority means the public sector entity that entered into the Agreement.

Authority’s Default means an Event of Default for which the Authority is responsible.

Authority’s Variation means a Variation requested or sought by the Authority.

Back Stop Date means, subject to adjustment in accordance with the Agreement, the last date by which the Concessionaire must complete the New Upgrades, failing which the Authority may proceed immediately to termination under the Agreement.

Below Rail Infrastructure means all infrastructures including the rail required for the delivery of a service to allow freight, and if relevant, passenger services to

use that infrastructure, details of which would be set out in a schedule to the Agreement.

Change in Circumstances has the meaning contemplated within section 2.18 of the Guide.

Change in Land Use means any use of land constituting all or part of the Site for which consent is required either at law or under the Agreement that departs from existing Land Use.

Change in Land Use Consents means the consents required either at law or under the Agreement to permit a Change in Land Use.

Compensation Event has the meaning described in section 2.16 of the Guide.

Concessionaire means the legal entity authorized to exercise the rights and perform the obligations set out in the Agreement and the counterparty to the Authority in the Agreement.

Concessionaire's Default means an Event of Default for which the Concessionaire is responsible.

Concessionaire's Variation means a Variation requested or sought by the Concessionaire.

Concessioned Assets means those assets that have been transferred to the Concessionaire, or the rights to use those assets have been transferred, as the same may be replaced, enhanced, or augmented by the Concessionaire pursuant to the Agreement.

Conditions Precedent means those obligations to be carried out by the parties in order that the Agreement may become fully effective, examples of which are referred to in section 2.4 of the Guide.

Confidential Information means that information that is to be kept confidential by the parties other than specific exceptions, examples of which are set out in section 2.21 of the Guide.

Date of Termination means the date on which the Term or the Agreement terminates; the concepts behind the two approaches are set out in section 2.24 of the Guide.

Direct Agreement usually means the agreement between the Authority, the Concessionaire, and the Funders or their representatives, which allows the Funders to receive notice of a Concessionaire's Event of Default and to exercise a remedy to take control of the concession to improve performance under the Agreement. Traditionally, a Direct Agreement allowed the Funders to appoint another legal entity to assume Concessionaire responsibilities under the Agreement, but in many jurisdictions, because of the laws on insolvency of companies, other remedies need to be exercised.

The expression is sometimes used in connection with agreements between the Authority and the principal contractors of the Concessionaire to allow the Authority to assume the role of the Concessionaire under those contracts in the event of a Termination under the Agreement.

Dispute Resolution Procedure is the process of resolving disputes between the parties arising under or in connection with the Agreement referred to in section 2.30 of the Guide.

Effective Date means the date on which all Conditions Precedent have been met, or compliance with Conditions Precedent has been waived under the terms of the Agreement, rendering the Agreement fully effective.

EPC means Engineering, Procurement, and Construction and the term EPC Contract has the consequential meaning.

Event of Default means either an Authority's Event of Default or a Concessionaire's Event of Default.

Financial Model means a mathematical representation of key financial and operational relationships. Comprising one or several sets of equations, the Financial Model is used to analyze how the business of the Concessionaire is due to operate. The Financial Model may include analysis of how key variables will respond to a range of economic situations or events; the model generally includes forecasts of capital expenditure revenues, operational expenditures and income estimates. Generally, a Financial Model is incorporated in computer software that includes cash flow projections, depreciation schedules, debt service, inventory levels, rate of inflation, and the like. Sometimes the model is represented in the form of spreadsheets; if the model is to be used for the purposes of the Agreement, it may be kept in electronic form and copies of the model held by a custodian for safe keeping.

Force Majeure means an occurrence outside the control of the parties and Force Majeure Events has the meaning discussed in section 2.16 of the Guide.

Funders in this document refers to the parties advancing funds to the Project and may include bondholders, but will exclude equity providers or those supplying equity-type finance through subordinated debt.

Future Upgrades refers to improvements to the Concessioned Assets that are likely to be required as the concession develops, but are not specifically required at the outset.

Independent Designer means the person or other legal entity who may be appointed by the Concessionaire, but more likely the EPC contractor of the Concessionaire, in circumstances outlined in section 2.9 of the Guide.

Independent Engineer means the person nominated by the Authority to monitor implementation of, among other things, the New Upgrades as discussed in section 2.5 of the Guide.

Insurance Certificate means the certificate issued by the relevant insurers evidencing the taking out of insurance by or on behalf of the Concessionaire.

Intervening Event has the meaning described in section 2.16 of the Guide.

Hand Back refers to the process of surrendering by the Concessionaire, to the Authority or its nominee, the rights of the Concessionaire in the Concessioned Assets and other assets as may be prescribed by the Agreement upon the expiry or earlier termination of the Term or the Agreement.

Hand Back Assets means those assets prescribed by the Agreement to be surrendered by the Concessionaire to the Authority.

Hand Back Date means the date upon which the Hand Back Assets are surrendered to the Authority.

Hand Back Failure is a failure by the Concessionaire to surrender the Hand Back Assets to the Authority in accordance with the Agreement.

Hand Back Procedures is the protocol or other written requirement attached to the Agreement setting out the steps to be taken in relation to surrendering the Hand Back Assets to the Authority.

Land Use means the use of land constituting the Site as permitted under the relevant legislation.

New Upgrades are improvements and additions to the Concessioned Assets, details of which appear in the Agreement, that are to be undertaken by the Concessionaire immediately following the Effective Date.

Non Defaulting Party means the party to the Agreement that has neither committed nor permitted the relevant Event of Default.

Notice of Intent to Terminate means the notice given by the Non Defaulting Party when the relevant Event of Default is capable of being remedied, notifying the other party that unless the situation is remedied within a specified time then the Non Defaulting Party will serve a Termination Notice. Sometimes the parties will endeavor to agree to a remediation schedule or program, in which case, the notice will relate to a failure to reach agreement on the program for remedial action.

Party means either the Authority or the Concessionaire; parties means both Authority and Concessionaire.

Permitted Release means circumstances under which Confidential Information may be disclosed to third parties.

Political Force Majeure Events means those exceptions to the rule on Force Majeure for which the Authority agrees to compensate the Concessionaire upon their occurrence, examples of which appear in section 2.16 of the Guide.

Rail Freight Operator means an operator responsible for freight train services that uses the Below Rail Infrastructure and who will be a Track Access Holder.

Railway Safety Board is a term of convenience in the Guide to refer to the legal entity responsible for safety regulation on the railways. The exact nature of the entity will depend upon host country law; if there is no person or entity legally responsible for rail safety, then safety would become contractually regulated under the Agreement until regulation was introduced through legislation.

Site means the area or areas of land made available to the Concessionaire for the purposes of fulfilling its duties and exercising its rights under the Agreement.

Senior Lenders means Funders that have made loans available to the Concessionaire and rank above all other creditors, unless a mixture of bond financing and senior debt is used, when the Senior Lenders will usually rank *pari passu*.

Specified Period means a period of time, typically measured in years, within the Term that is identified, and during which specified outcomes are to be achieved.

Guide refers to this explanation of components of an Agreement. The Guide will address major issues, although many detailed issues must also be considered. Just as “beauty is in the eye of the beholder”, opinions will differ on which details should be included here.

Term means the period granted by the Authority to the Concessionaire for the latter to exercise its rights under the Agreement. The Term should be sufficient to allow the Concessionaire to repay all the capital advanced by Funders and otherwise service those debts and to pay a dividend to equity providers commensurate with risks borne by them.

Termination Notice is the notice given by one Party to the other specifying the date in accordance with the Agreement on which the Term and where appropriate, the Agreement, will end prior to the full period of the Term.

Third-party Liability means the duty of care or absolute duty arising at general law or under specific legislation not to damage the interests of third parties owed by a legal entity towards another legal entity including a person and the claims that may arise consequent upon a failure to meet that duty.

Track Access Applicant is a train operator that applies for passage of its rolling stock over the Below Rail Infrastructure for specified times and durations, often referred to as ‘train paths’.

Track Access Holder means a train operator with an existing right to utilize specified train paths. If a Track Access Holder applies for additional train paths, for the purposes of the application, it will be designated as a Track Access Applicant.

Transport Regulatory Commission is the term used for convenience in the Guide; it is the legal entity responsible for either or both economic and quality of service regulation on the railways. The exact nature of the entity will depend upon

host country law; if no person or entity is legally responsible for such regulation, it would become contractually regulated under the Agreement until regulation was introduced through legislation.

Variations means a change requested by the Concessionaire or by the Authority regarding the Concessioned Assets or the services to be delivered under the Agreement that differ from those planned or executed as New Upgrades or Future Upgrades.

2.4 *Conditions Precedent to the Effective Date*

Most Agreement provisions will not come into effect until specified key requirements have been met; this provision specifies the key requirements (Conditions Precedent).

Some key requirements are more technical, such as each party obtaining all necessary authorizations to be bound by the Agreement, and legal opinions that the authorizations have been properly obtained.

Other key requirements are more substantial, such as the Concessionaire executing binding funding agreements with funders.

If the Concessionaire is to procure the issue of a performance bond or similar, the timing for its issue should be dealt with under conditions precedent, although the provisions for obtaining bonds may be set out elsewhere (see Bonds post).

Provision will be required for a cut-off date to achieve the conditions, or receive a waiver if feasible and for the consequences of failure by either party. In the case of Concessionaire failure, if the tender documents have so provided, it might be appropriate for the Authority to call the bid bond.

2.5 *Conditions Precedent to the Start of the Term*

On the assumption that the operational phase and the construction phase for New Upgrades will start on commencement of the Term, specific steps must be achieved in order for the Concessionaire to start undertaking its obligations.

- The Concessionaire may require a license to operate; separate licenses may be required for infrastructure operation and train operation;
- Where New Upgrades require a change in Land Use and this is to be obtained by the Authority, it should have been obtained;
- Where New Upgrades are substantial, it may be prudent to appoint a third party (the Independent Engineer) to ascertain that the design and construction are carried out in accordance with quality control procedures. If so, the Independent Engineer should have been appointed;
- Relevant insurances should have been obtained such as contractors' all-risk, property insurance, employer's liability insurance and, from a state perspective—the more important, third-party liability coverage;

- Conditions precedent to first draw down under the funding agreements should have been met, other than that requiring the commencement of the Term;
- If a direct agreement between the Funders and the Authority is required to allow time for the Funders to arrange new management of the existing Concessionaire or a replacement Concessionaire, or both (satisfactory to the Authority), then that agreement should have been executed;
- Any capital payment to be made by the Concessionaire as a concession fee or similar should have been paid, or in the case of installments, the first installment should have been paid;
- Approval of the safety regime (possibly through a safety case) should have been obtained from the Railway Safety Board; this may require separate clearances for the infrastructure operation and rolling stock operation;
- Employees should be ready to transfer from the state to the Concessionaire;
- Third-party access terms should have been agreed with the Transport Regulatory Commission, as should pricing under the charging regime—or in accordance with whatever regime applies in the host country;
- Where the Transport Regulatory Commission or other authority has approval of tariffs for freight charges, approval should have been obtained; and
- A renewals and maintenance regime for the first Specified Period, perhaps five years, has been agreed with the relevant body or bodies.

A cut-off period for achieving these conditions should be provided for and the consequences of not achieving them should be set out.

2.6 *Term*

The Agreement must specify the length of the Term or its duration. The duration should reflect all relevant matters; see below.

The Authority will wish to specify a duration that is expected to result in the best value-for-money solution for the reform. Factors to be taken into account when deciding on the duration of the Agreement will include the following:

- Any service requirements imposed by the Authority under the Agreement;
- The possibility of further reforms, which might require significant changes to the approach to the rail system;
- Affordability of services for users and for the Authority, taking into account the expected useful economic life of the underlying assets. Longer duration may be preferred, from an affordability perspective, if assets involved in delivering services have a longer economic life—bridges and other major structures;

- Need for and timing of major refurbishment or asset renewal programs during the Term;
- Likely Senior Debt term, and potential for refinancing the concession over a longer debt service period, which could increase the duration; and
- Potential for an option to extend the term of the Agreement by entering into a further contract period with the initial Concessionaire.

Both Authority and Concessionaire should be cognizant of inevitable rapid pace of technological change. Also, as the economy grows, the diverse requirements for transport will rise along with the risk of an increasing share of freight haulage by road. Furthermore, rising affluence increases the desire for personal vehicle ownership, particularly automobiles, and increases competition from low-cost airlines. Accordingly, the Authority's requirements are likely to change during the period of the Term. The Authority should be able to ensure that the regimes under the Agreement are sufficiently flexible to allow changes to the service over time. If, however, the Authority is concerned that changes will be sufficiently radical that the concession in its existing form may become redundant, the Authority may wish to retain flexibility through shorter contract periods, consistent with an affordable financing plan.

The impact of intervening events on the duration of the Agreement is dealt with in the item on Intervening Events in section 2.16 below.

Subsequent Guide provisions will address circumstances upon expiry of the Term and termination. The host country law and practice will determine whether termination prior to Term expiry should be that of the Term, or of the Agreement. There may be some advantage in terminating the Term, and dealing with consequences of termination whilst the Agreement continues to exist.

2.7 Concession

It is highly unlikely that all the assets to be used by the Concessionaire will have been identified by the time the Term commences, let alone by the time the Concession Agreement is executed. Examples exist of sets of wagons found on larger systems some time after the private sector has taken over the Concession. Therefore, the grant of rights should be sufficiently generic to include all the assets that the Concessionaire might reasonably need. However, if there are interfaces with other systems that are not intended for inclusion in the concession, it may be sensible to specify a transition period during which it might be ascertained that certain assets would be more appropriately kept within another system, and a transfer can occur to or from the concession.

The right granted also needs to be considered. Funders will want to know whether the use of the Concessioned Assets is exclusive to the Concessionaire and cannot be claimed by third parties or used by others, except as specifically envisaged within the terms of the Agreement. The public sector will want to know that the assets will be available to meet any public service obligation in the event of a serious Concessionaire default. Thus, the concession rights might be an exclusive right

to operate and the assets will remain vested in the state; any assets the Concessionaire develops in the future will become vested in the state as soon as such assets are put into use. In some jurisdictions, the state will lease real and moveable property to the Concessionaire, but this would not be an option if the law offers protection from lease termination, particularly if a company becomes insolvent.

Other considerations include whether the state wishes to allow the Concessionaire to claim capital expenditure against profits (capital allowances) and what interest in the assets the Concessionaire must hold to obtain those allowances.

If assets are vested and are to be vested in the state, a mechanism is needed to allow temporary removal of assets that are in need of repair and renewal, or when assets are removed for replacement, a transfer to the state of replacement assets.

To the extent possible, the Authority should offer no warranties and should exclude all liability in relation to asset condition. If the Concessionaire adopts previous designs of New Upgrades prepared by or on behalf of the state, liability for those designs should be excluded on the basis that all bidders will have had time to validate the designs.

If an inventory of spare parts exists for the overall system, not just the concessioned railway, then a split of the inventory should be carried out and allocated as appropriate among the Concessionaire and others.

Emergency access points to rail infrastructure may be required, and rights granted to the Concessionaire to pass over adjacent lands to access rail infrastructure. Similar arrangements may be necessary to carry out repairs and renewals and to access watercourses, if required by drainage arrangements.

The nature of the concession needs to be set out:

- Is it a right and obligation to renew, maintain, and operate the Below Rail Infrastructure for freight?
- Is it a right to operate freight services?
- Is it a right and obligation to renew, maintain, and operate the Below Rail Infrastructure for rail passenger services?
- Is there an obligation to provide third-party access to the Below Rail Infrastructure and does the access include international services, domestic services, freight and/or passenger services?
- What property rights are included? Can property or property rights be removed from the concession if such removal is for public good?
- Is the Concessionaire allowed to exploit the track area, e.g., through telecoms cables or cell-net masts? If so, is the revenue received considered regulated or unregulated income?

The nature of the rights granted needs to be considered. In the case of Below Rail Infrastructure, is it an exclusive right for a geographic area? What happens if a private company wishes to construct a dedicated private line, e.g., between a mine or quarry and a manufacturing process? What happens if a private company wishes to construct a spur line? Instead of granting an exclusive right for a geographic area, it is suggested that the Authority should agree not to subsidize competing lines.

The scope of the concession requires careful analysis, particularly the boundaries with other infrastructure.

- Initially, many traffic crossings will be at grade but where there are tunnels and bridges, responsibility for upkeep needs to be established and if not clearly reflected in statute law, should be set out in the Agreement.
- If equipment is to be supplied, the supply of emergency equipment such as heavy lifting gear needs to be addressed. Should it be made available for other users? In addition, if the Concessionaire is to purchase new equipment such as a track geometry vehicle, is this to be made available for use in other areas?
- If stations and other facilities are to be shared, it is advantageous to establish the lines of demarcation and an operating regime in an effort to avoid future conflicts between affected parties on interface issues.

2.8 *Independent Engineer*

If New Upgrades are scheduled, it may be sensible to establish a neutral specialist to monitor quality assurance and to confirm that Upgrades are ready, without compromising the overall Concessionaire responsibility. To a degree, safety aspects will normally have to be reviewed by, e.g., the Railway Safety Board. Therefore, the Independent Engineer should review design and construction procedures against an agreed quality assurance regime, *not* carry out the detailed and involved role of a site engineer. If procedures are to be developed during the Term, the Independent Engineer should check that those procedures were developed according to then-ruling control documents.

Notwithstanding the role of the Independent Engineer, the Concessionaire must remain responsible for the design and works.

Usually the Authority appoints the Independent Engineer, but developing appointment terms and identifying the appointee is usually carried in consultation with the Concessionaire. Typically, the minimum requirement is that the appointee has an international reputation within the relevant fields of expertise.

Provision should be made for circumstances in which the Independent Engineer is unwilling or unable to act, or there is a performance failure that leads to appointee replacement, after consultation between the Authority and the Concessionaire.

2.9 Commencement of New Upgrades

After the Term commences in which there are to be New Upgrades, a development phase follows during which the Concessionaire finalizes design, carries out construction, procurement, and testing of, and commissions New Upgrades. New Upgrades specifications set out in the Agreement typically specify outputs. The Concessionaire is completely responsible for all design, construction, integration, installation, testing, commissioning, and ultimate performance of any asset procured or developed for the purposes of meeting the requirements of output specifications. A bidding procedure requirement may have been that bidders were asked to supply details of their proposals to meet the output specifications, and the Concessionaire's proposals will become part of the Agreement. A careful review of host country laws on liability should be conducted. Any Authority or Independent Engineer review of design or construction should not allow risk for design and construction to migrate from the Concessionaire to the Authority. In some jurisdictions, better protection against risk is afforded by adopting a no-objection procedure, rather than an approvals procedure. In any case, clarity should be established so that no review by the Authority or the Independent Engineer will relieve the Concessionaire of responsibility and liability with respect to design and construction.

If New Upgrades require major structural works such as tunnel or bridges, or the work is to be carried out on a site where there has been previous but indeterminate works such as mines, responsibility for site condition might be unclear. Generally, the Concessionaire should take responsibility for site conditions, but during the bid period on a linear project it may be difficult for a bidder to obtain reliable information on soil and subsoil conditions. One solution might be for the Authority to obtain site survey reports, and to assign the report and its underlying contract to the Concessionaire after the Agreement is signed. If this is not feasible, the issue of site risk may have to be carefully considered in each circumstance. However, if adverse site conditions pose too great a potential downside to be borne by the Concessionaire (meaning, exceeding the Funders' risk tolerance) then some cost-sharing mechanism will need to be included.

The Authority should take no responsibility for construction and procurement risk, unless exceptional circumstances are present. Therefore, the Concessionaire should be allowed the freedom to manage its own activities without Authority interference. The Concessionaire is completely responsible for satisfying service requirements under the Agreement; therefore, it accepts any risks associated with implementing the design and development, and establishing operational procedures. The Authority should not agree to any role before or following commencement of the Term that involves assuming any part of Concessionaire risk, unless under exceptional circumstances, for example, anything that would give rise to the Authority stepping in and arranging temporary operations for all or part of the facilities. In this context, the issues referred to in section 2.9 are important.

The deadline for the Concessionaire to complete the New Upgrades should be explicitly stated. Incentives may be better than penalties to encourage the Concessionaire to complete the Upgrades on time, for example by preventing increases in tariff or service payments until specified degrees of completion are achieved, rather than claiming damages for failure to complete on time.

If the scheme must meet a public service obligation, the Authority bears a residual risk if the scheme should get into difficulty. Therefore, it is advantageous if the Authority has mechanisms to verify Concessionaire progress. One such method is to audit the application of a quality control program and for that purpose the Concessionaire should develop a quality assurance procedure in accordance with its proposals submitted at the time of tender. These procedures may be signed off on a no objection basis by the Independent Engineer. It might be prudent for the Authority to require that the Concessionaire procure the services of an Independent Designer to monitor or review the design and construction. The Independent Designer is appointed by either the Concessionaire or more likely by the Concessionaire's construction contractor. The Independent Designer should have an international reputation and should sign off on all key designs for important structures. For other designs, a less onerous signing-off regime could be developed. The Independent Designer could issue certificates to confirm that design and construction were prepared or carried out according to the requirements of the Agreement, or according to the lighter regime, and present these to the Independent Engineer along with the relevant design. This can be done electronically if the Independent Engineer and the Authority have 'read-only' access to the Concessionaire or contractor design databases.

If the Concessionaire is to provide key equipment, the supplier(s) should be identified in the Agreement, or a list of agreed prospective suppliers could be set out in the Agreement, leaving the Concessionaire to negotiate the best value with those listed.

A regime for testing during works implementation, and for testing and commissioning to achieve completion should appear in the Agreement. The Concessionaire should develop a completion schedule specifying tests, sequencing, and timing. The completion schedule should include provisions relating to periods for notification of testing, implementation of commissioning procedures, attendance of the Independent Engineer and the Authority, and protocols for retesting in the event of failure. The Authority would benefit from including some tolerance to allow financial adjustment if specified standards are not achieved.

Should the Agreement include a right to terminate the Contract if a core standard level is not met? That depends upon the particular New Upgrade, but if a right to terminate is included, the Concessionaire should be given a reasonable amount of time to overcome the default but with a final cut-off date.

The Independent Engineer and the Authority should be given access to the place of manufacture and the site of the New Upgrades; the Concessionaire should be required to ensure that contracts with its contractors and between its contractors and their sub-contractors allow for this.

For larger-scale New Upgrades, the Authority may wish to review the Design/ Construction/ EPC Contract. The aim of this review is to avoid problems that might otherwise arise in case of mismatch between Agreement provisions and Concessionaire procurement, not an opportunity for the Authority to interfere in the relationships between the Concessionaire and its contractors. Normally, if there is project finance, Funders prefer works to be carried out under a unified 'design-

build' contract to avoid the risk of a dispute between separately engaged designers and construction contractors because otherwise this would leave a residual construction liability with the Concessionaire.

If there is third-party access over existing infrastructure, the Agreement should include a mechanism to deal with Track Access Holders' rights, if possessing portions of the track is required during construction or commissioning or both. Initially, freight traffic is unlikely to be as time sensitive as passenger traffic, however, as rail use is promoted, supply chain arrangement for just-in-time collection and delivery may be developed. The regime should differentiate between scheduled possessions and over-runs. Sometimes it is more efficient to allow longer-term possessions of all the tracks in a relevant area (blockades).

2.10 Role and Obligations of the Authority

Usually, prior to signing the Agreement, the role of the Authority includes the following:

- Defining output requirements and any constraints within which the output requirements must be achieved;
- Reviewing and evaluating Concessionaire proposals to achieve outputs in terms of approach, methods, resources, timetable, management, and organization, including maintenance and operational procedures; and
- Negotiating and agreeing on all contractual terms with the Concessionaire.

In accordance to these principles, the Authority should not confirm with the Concessionaire that its proposals will meet the service requirement. In practice, however, the Authority should be confident before signing the Agreement that once fully developed and implemented, Concessionaire proposals can deliver the service.

The Authority's role after contract signature and prior to the Term commencing may include the following.

- Appointing the Independent Engineer;
- Obtaining any necessary Change in Land Use Consents;
- Assisting in obtaining temporary and permanent import licenses for material and for equipment, and immigration consents for key personnel;
- Working with the Concessionaire to identify staff to be transferred to the Concessionaire and dealing with issues arising from staff not to be transferred;
- Transferring to the Concessionaire the necessary rights in the Concessed Assets both in their entirety and punctually; and
- Where appropriate, entering into an intercreditor agreement referred to in section 2.11 and a Direct Agreement with the Concessionaire and Senior Lenders.

The role of the Authority after Term commencement, and to a degree before, may include the following:

- Paying any service payments or other payments to be made under the Concession Agreement whether of a capital or revenue nature and allowing adjustments in accordance with the Agreement for inflation and, where relevant, currency fluctuations;
- Reviewing and commenting on any changes (Variations) to Concessionaire designs and construction proposals as they are developed; this should not be confused with the continuing role of the Independent Engineer;
- Reviewing and commenting on Concessionaire maintenance, renewal, and operational procedures, to the extent these are not addressed within the role of the Rail Safety Board and the Transport Regulatory Commission;
- Viewing and observing tests of any equipment being developed;
- Administering the agreed process for the Concessionaire or Authority to propose and implement changes to output requirements, constraints on inputs, or Concessionaire proposals, to the extent these are not addressed within the role of the Rail Safety Board and the Transport Regulatory Commission;
- Accessing management information to ensure the delivery timetable is on track and any overriding safety issues are being satisfactorily addressed, depending on the scope of Authority exposure to the scheme. This may include access to the site and places of manufacture; rights of access that should extend to the Independent Engineer.

Principles outlined in this section 2.10 reflect an intention to ensure appropriate risk transfer during the period leading up to the commissioning of the New Upgrades and beyond.

2.11 Concession Fees

Should the Concessionaire make a capital payment for using concession assets in addition to the obligation to supply New Upgrades? This will depend upon how robust the business case is, which in turn depends upon whether the Authority wishes the users to include within the payments to the Concessionaire, a portion towards the return of, and return on, that capital payment. Bidders will evaluate all the risks and any up-front capital payment will be fixed with those risks in mind. Where the amount of the capital payment forms part of its bid rather than being fixed by the public sector there is likelihood that bidders will be more conservative in relation to any up-front payment.

If a capital payment is to be made, it could be paid immediately before the Term commences, by installments, or partly through a capital payment and partly through a debt to the Authority, which is subordinated to the senior debt from Funders but ranks ahead of equity. This does not mean that Concessionaire share-

holders will receive no return until the subordinated debt is paid, but if the concession gets into difficulties the subordinated debt will rank ahead of shareholders. Thus the business case would have to be robust before shareholders would accept greater risk to their investment.

If subordinated debt is used, this would be reflected in separate loan documentation including a form of inter-creditor agreement between Government and Senior Lenders.

In addition to or instead of a payment of capital monies, the Concessionaire may be required to pay annually an amount fixed by reference to turnover or other amount, perhaps based on the idea that after achieving an annual turnover target, any surplus should be shared. Issues to consider include whether the target is fixed before or after discounting for inflation, and whether any regulator rules conflict with this approach. If a lease is used, the payment may be made under the lease; however, it is preferable that all operative provisions of the agreement between the Concessionaire and the Authority should appear in one place, leaving the lease document in a simple form.

2.12 Bonds

The Concessionaire will add the cost of any surety bond(s) to its total costs, which it will then wish to recover from users and, if the Authority makes a payment to the Concessionaire, then within that payment. Thus, bonds should be used only if a strong cost/ benefit case can be made. In most cases, if the Concessionaire fails, an immediate cost accrues to the Authority; therefore it is recommended that all bonds issued be callable on demand.

The different types of procurement procedures are addressed in Chapter 13. It should be borne in mind that the use of a bid bond within the context of a negotiated bid is not without difficulty. The bond merely supports bidder commitment to enter into a contract based upon its bid. If there are negotiations, the original bid will be superseded by subsequent negotiations; therefore, an argument can be made that the bond is no longer enforceable. Another option would be to negotiate with more than one bidder and to request that they submit their 'best and final offers,' each supported by a bid bond. Yet another option is to have discussions at prequalification or pre-bid stage, and request bids with bid bonds, based on the winning bid being countersigned by the Authority to make the Agreement. Regardless of the option selected, the bid bond should be extended to cover the achievement of Conditions Precedent to the Agreement becoming effective.

As indicated, a performance bond that lasts the life of the Term is unlikely to be cost-effective. The considerable expense that the winning bidder has incurred to reach that stage creates an incentive to proceed. However, it may be prudent to have a performance bond—specified by either time period, or expenditure level. Shareholder investment, for example in New Upgrades, coupled with Funder loans puts real risk money at stake, some or all of the benefits of which will accrue to the Authority, although the benefit will be less if there is a full payout to the Funders regardless of the reason for termination. A considerable amount is at stake; thus, a performance bond provision should not only stipulate a financial institution with a high credit rating, specifying the credit agency and rating, but also allow the bond

to be returned to the issuer at a point specified by either time period, or expenditure level.

The interval just before the Term expires is the next period when the Authority is most exposed to risk. Usually, there will be a requirement that on expiration of the Term, assets should be of a standard commensurate with rail system operation (see Hand Back post). At a suitable point in time before expiration, concession assets should be inspected. To the extent work is required to reach that standard, the Concessionaire should lock up dividends and other payments in an escrow account sufficient to meet the requisite expenditure; or the Concessionaire should procure a bond issued (by an issuer of the same financial strength as for the issue of the performance bond). The escrow account or the bond should exist until the requisite work is complete and the final inspection, which would ordinarily take place after Hand Back has been satisfactorily carried out.

2.13 Obligations of the Concessionaire

To the extent economically and commercially sustainable, Concessionaire rights and obligations pursuant to the Agreement should be at Concessionaire cost and risk, without recourse to Authority credit or guarantees. If the Authority intends financial support, whether actual or contingent, the basis should be specified in the Agreement.

Unless the Agreement includes contrary provisions (for examples, see the concept contained in section 2.20 (Preservation of Concessioned Assets) it may be appropriate for the Concessionaire to have unrestricted authority to negotiate terms and conditions of all necessary contracts with all suppliers, commercial service providers, and users in respect of the concession and its obligations under the Agreement. If Authority financial support is involved, Concessionaire procurement rules and procedures and the extent of their application should be agreed in advance between the Authority and the Concessionaire.

To the extent viable under the circumstances pertaining to the scheme, the Concessionaire should agree to raise the required finance to complete the New Upgrades in accordance with Agreement terms and conditions. If loans and credits are sought to be arranged based on Authority guarantees or backstopping such loans in favor of the Funders, then more of the scheme's risks will fall on the Authority, actually or contingently. In economic terms, this may mean that the Authority will assume some construction and operation risk through required payments to the Funders, without the Authority receiving a compensatory amount from any other source, particularly when facilities are not operating properly. The Authority should avoid to the fullest extent practicable becoming a direct party to any finance commitments with Funders, other than under the inter-creditor agreement between various Funders and the Authority, where the Authority has agreed to a subordinated debt arrangement, or any Direct Agreement. Funders should be able and encouraged to proactively support the scheme in the event that the Concessionaire has difficulty meeting obligations under either or both the Concession Agreement and the Funding Agreements. Provided that any Direct Agreement imposes no greater liabilities on the Authority than under the Concession Agreement, then it is in the interests of the host country to allow the Funders to take control of the scheme and the Concessionaire to rescue the scheme. How the Funders can

effect the rescue depends upon the insolvency law and practice of the host country and the Direct Agreement will reflect that.

The Concessionaire should be permitted to provide certain assets as security to the Funders. The extent of the security that may be given will to a degree reflect the concession rights granted.

In addition to the New Upgrades, the Concessionaire should ensure that the Below Rail and other Infrastructure is renewed and maintained to a level that enables sufficient capacity to handle the potential freight and other traffic on offer. With this in mind, it is probable that potential demand should be reviewed periodically and review results implemented.

As indicated earlier, a full list of assets is unlikely, much less, an asset condition register. If the Concessionaire is delivering either or both New Upgrades and renewals, it would be advantageous for an asset condition register to be prepared and subsequently maintained. The extent of the register would depend upon a cost/benefit analysis carried out during the study for reforms. Since the register is likely to be maintained electronically, the Authority should be given 'read-only' access to the database.

At a minimum, the Concessionaire should negotiate in good faith with intent to agree with the Authority on terms and conditions for Future Upgrades of any lines, if existing Below Rail and other Infrastructure would constrain planned increases in demand that arise from the review, in order to handle additional freight traffic and technical standards. The Agreement should address setting aside funds to finance Future Upgrades if this issue does not fall within the arrangements between the Concessionaire and the Transport Competition Board.

Of necessity, contractual regulation under the Agreement must govern regulatory matters and will require one or more schedules. If regulation exists under legislation, the Transport Competition Board (referred to in the Introduction) will have a significant role as regulator to allow an adjustment in tariffs and track access charges if there is an issue as to whether Future Upgrades will be commercially viable, as opposed to economically viable, the Authority may need to make available capital grant or other funds to cover the whole or partial cost of Future Upgrades.

Host country law will determine whether to include a provision that requires the Concessionaire to carry out its obligations in accordance with the law, including the law on safety. If Concessionaire failure to observe the law might cause loss to the Authority, it may be appropriate to require the Concessionaire to observe the law. Otherwise relevant government enforcing arms would be responsible to enforce the law if the Concessionaire were in breach. Nevertheless, the Agreement should include provision for the Concessionaire to perform in accordance with Good Industry Practice, which might be defined as, "in respect of any undertaking in any circumstances, the exercise of that degree of care, foresight, prudence, and skill that would reasonably and ordinarily be expected from a competent, skilled and experienced person in the same type of undertaking in the same or similar circumstances."

The issue of rail passenger traffic depends upon the structure chosen. If the Concessionaire is to supply infrastructure services, it may be an option for the Concessionaire to supply infrastructure to a service level suitable for passenger traffic. This could be addressed under a separate services contract, particularly where the potential exists under the Agreement, for the Authority to have power, on notice, to remove certain of the Below Rail Infrastructure from the category of Concessioned Assets and place them with another services provider if the parties fail to agree on changes to the pricing structure or scope of the services. If the Authority does wish to include passenger transport services within the Agreement then it will need to include provisions relating to such matters as fare and service levels, stations/other stops, and passenger claims and complaints.

The level of detail for third-party access and charging regimes in the concession will depend upon how comprehensive legislation is in the host country—the less detail in legislation, the more the detail required in the Agreement. Similar issues relate to a Track Access Applicant's requests for access, and a Track Access Holder's requests for increased access. Analogous issues arise in relation to regimes for failure to give access, failure to give access to agreed paths, delays in journey time, and the like.

The risk of an arbitrary regulator decision will be of particular concern to the Concessionaire where, in cases regarding terms of access, there could be either or both an increase in the Concessionaire costs and tariffs, which could reduce Concessionaire income. These issues, which concern both Concessionaire and Funders, might be addressed under Compensation Events. Although achieving a balance is difficult—the role of the regulator is to ensure that Concessionaire revenues are sufficient to meet its obligations, but not to the extent that ensures compensation for poor Concessionaire management decisions.

Should access be given to infrastructure other than track? For example, should access be given to maintenance or rail freight depots? Should passenger train operators be given access to stations? Similar to situations discussed earlier, the detail required in the Agreement depends on whether host country legislation is comprehensive.

Another issue is international third party access. This does not affect 'islanded' systems with no cross-border link or no plans to link in the near or medium future. If cross-border rail traffic is likely, consideration should be given to incorporate Concessionaire obligations to allow for this. Even if the host country is not a COTIF signatory, COTIF provisions could be a useful benchmark to indicate potential considerations for bidders, until details of arrangements between the host country and its neighbors emerge.

The Concessionaire should also meet all safety requirements, and this is another case of looking at how comprehensive host country legislation is in this respect. If the Concessionaire must approve safety arrangements, e.g., safety case of Track Access Holders, or Track Access Applicants, the Agreement should address the processes to the extent they are omitted from host country legislation.

A disaster recovery plan should be linked to safety issues and agreed between the Authority and the Concessionaire. The disaster recovery plan should set out reporting lines (see also section 2.23), and make provision for changes, based on emerging experiences from incidents or accidents, to be agreed or otherwise addressed.

2.14 *Insurances*

The Concessionaire should be expected to take out common insurances typically acquired by any prudent business. Some insurances may be required by law, e.g., worker compensation, but other insurances are more important from Authority perspective, particularly if assets remain or become vested in the state during the Term, including the following:

- Contractor's All-Risk insurances during construction; cover during freighting of equipment or materials, should be considered, particularly if the state is advancing capital to pay for some of the New Upgrades;
- Insurance on the Below Rail and other Infrastructure;
- Third-party liability cover; and
- Business interruption cover to compensate for lost revenue, which may be caused on the occurrence of an insured peril. Similar cover should be taken out in respect of losses that may occur as a consequence of delayed completion of New Upgrades. It is not unusual under a specific obligation in concession-type agreements for the private sector party to take out this cover as it adds to the robustness of the structure being created.

The period and amount of specific covers should be stated and the Authority should be a named insured.

The Concessionaire should provide an insurance broker's letter to confirm that the broker will notify the Authority if, prior to renewal, there is an indication that cover will not be renewed or that conditions of renewal will be onerous.

Current Insurance Certificates should be produced to the Authority; if the Concessionaire fails to take out key insurances then the Authority should be able to take out the insurance and recover the premia from the Concessionaire.

If insurance cover is unavailable in the market or available only at a commercial premium (unless this was due to Concessionaire acts or neglect) then the Authority should, at the time of non availability, be able to allow the concession to continue or could terminate the concession as though the non availability was a Force Majeure Event. If the Authority wishes the Agreement to continue then, in effect, the Authority itself would assume the risk for so long as cover is unavailable. For the Authority the key issue is to assess the level of risk incurred if it allows the circumstance of no cover. There is the common risk of claims by third parties if there is third party liability without insurance cover—the Authority will be seen to have deeper pockets than the Concessionaire. There is a risk to the economy if

there is major property damage and the Concessionaire has no funds to put right the damage, thereby delaying freight transport and possibly, passenger transport.

To protect the Authority, it is recommended to establish a requirement that the insurance policy must include a cross liability clause such that the insurance shall apply to the Authority, even if the Concessionaire made a material misstatement in the application for insurance cover. There should be waivers of rights of subrogation as against the Authority so as to reduce likelihood of a claim against the Authority where it is a named insured.

To avoid the Concessionaire taking the money and walking away from the scheme, the Concessionaire should be required to apply or procure the application of the proceeds of any claims in a manner specified in the Agreement.

2.15 *Liability and Indemnities*

The Concessionaire should assume all liability as regards the Authority in relation to the operations under the concession, other than, and to the extent that the Authority or those for which it is responsible, caused the loss or damage.

If there is damage to third parties, which may include passengers or their property, the Concessionaire should indemnify the Authority against claims by those third parties, other than and to the extent that the Authority, or those for which it is responsible, caused the loss or damage. The Agreement should also specify how the legal and other processes arising from such claims should be handled.

Environmental and other conditions

The Concessionaire has no responsibility for any events or conditions prior to the grant of the concession. Therefore, it is reasonable that the state should remain liable for any pre-existing hazardous waste and, if removal is required by law, the Authority should bear the cost of remediation. All subsequent environmental impacts should be at the risk of the Concessionaire. Although it is unlikely that a full-site survey has been carried out, it is highly desirable to carry out an environmental audit *before* final bids have been received to create a reasonable understanding between parties as to what environmental conditions may be expected. If there is a history of environmental pollution, prior to the grant of the concession it may be helpful to appoint an environmental expert to deal with any disputes that may arise during the initial years of the concession.

The host country law should preclude third-party claims arising from the usual noise and vibration emanating from the railway as a result of its usage in accordance with Good Industry Practice. The Concessionaire should remain liable for excessive noise and vibration, i.e., if Good Industry Practice was not applied and the cause of the problem is that the Below Rail Infrastructure and/or equipment have not been properly maintained (allowing that early in the Term, the Concessionaire will need time to put the infrastructure and equipment into good working order).

If the host country law does not cover chance finds of antiquities then the concession should set out the rules governing their discovery. If the law allows any chance finds to become the property of the finder then the Agreement should provide that

chance finds belong to the Authority and should be dealt with either by the Authority or under its instruction. The impact of discovery can be dealt with under either or both Force Majeure Events and Compensation Events (see post) although larger objects may require time to allow experts to carry out excavations and investigation.

Linked to the issue of site conditions is the issue of latent defects. To a degree this turns upon the scope of the maintenance and renewals envisaged under the concession and the timing of implementing that work. The main issue will be critical structures. If major works are not envisaged for identified bridges, tunnels, and buildings, then it is arguable that the Authority has accepted this. Therefore, if it later emerges that major work is required, reasonable cost for that work should be borne by the Authority. If, however, it is envisaged that major work will be carried out at some future date, this may be an issue of timing; thus, if the Concessionaire has had insufficient time to generate a sinking fund for these works but has otherwise behaved prudently, the Authority might consider advancing funds on a subordinated basis to meet the gap between actual expenditure and the expected date of expenditure at the time the Agreement was executed.

2.16 *Intervening Events*

These are incidents that affect the ability of one party to the Agreement to perform its obligations or receive benefits due under the Agreement. There are many ways to identify and specify consequences of Intervening Events. This Guide includes Compensation Events, Force Majeure Events, and Political Force Majeure Events.

Compensation events

Compensation Events are designed to cater for incidents that arise at the Authority's risk, resulting in a loss of income or increased costs to the Concessionaire. Such events are more appropriately dealt with by compensation methods rather than through Authority Default. Termination should be a last resort in every circumstance, although if an event renders the parties' contractual relationship untenable, the Authority may choose to exercise its voluntary termination rights.

Examples are:

- Authority breach of an obligation, including any breach occasioned by third parties for whom the Authority is responsible;
- Authority Changes or certain Future Upgrades; and
- Discriminatory or specific changes in law.

The Authority should bear the effects of certain Changes in Law and it may, after careful consideration in certain schemes, be appropriate to add other (or railway sector) specific events.

The Authority may face a request from the Concessionaire or its Funders to consider additional items as Compensation Events. If the obligation is to make payment by a due date, additional compensation is not required, as nonpayment is addressed through provisions dealing with interest on late payment

If a Compensation Event occurs during the execution of New Upgrades, the planned completion date may have to be postponed; usually by the length of any delay caused (any long-stop date will be similarly put back). If revenue or increase in revenue commences only when construction is complete, a practical consequence is that the start date of the Concessionaire's revenue stream or the start date of increase in the revenue stream is also delayed and additional costs are incurred. As a result, the Concessionaire may suffer significant additional expense through finance charges and additional costs.

Therefore, prior to contract signature, it must be decided how to compensate the Concessionaire for any delays in completing the New Upgrades that are the direct result of a Compensation Event. One option is to retain the original Expiry Date for the Term and compensate the Concessionaire for its loss; as an alternative, the Concessionaire may agree to extend the Term.

If the Agreement includes provisions for liquidated damages, then the Concessionaire's liability for liquidated damages will also require relief for the period of delay caused by the Compensation Event. Otherwise, the liquidated damages provision risks failing completely, particularly if there has been a failure by the Authority. The Concessionaire should also be relieved of any other liability for Authority losses in respect of the Compensation Event. This relief should be taken into account in determining consequences for the Authority of a Compensation Event. The main advantages of not extending the Term are first, simplicity, and second, Funders prefer this option because it preserves the senior debt loan life cover ratio and equity return. Also, this approach offers the better incentive to the Authority to manage its rights and obligations during the construction phase in a way that avoids delay.

The Concessionaire should be obliged to exercise reasonable efforts to mitigate its losses and costs, for example, by rescheduling the works timetable or redeploying staff, which in the case of New Upgrades, could avoid delays to the planned completion date, although mitigation may incur extra costs.

A common way to deal with Compensation Events is to rely on the Financial Model prepared at the time of tendering. By using the model, the parties calculate how and when compensation should be paid. Typically this would require the Authority to agree that the senior debt loan life cover ratio and equity return are to remain unchanged. However, if changes have occurred in assumptions used in preparing the Financial Model between the Agreement execution date and the circumstances giving rise to the claim, then the use of this mechanism could risk over rewarding or under rewarding the Concessionaire. Sometimes, changes in factors can be imported into the Financial Model. Nevertheless the Agreement should be drafted so that Compensation Events require as simple an approach as possible and the sole concern is to ensure fair compensation for a limited number of events, which can be calculated in a straightforward manner.

Force majeure events

Force Majeure Events are incidents that prevent the Concessionaire from performing its obligations at any time, for which the Concessionaire bears the financial risk in terms of increased costs and reduced revenue, but for which it is allowed relief

from termination for failure to meet its obligations under the Agreement to the extent that the Force Majeure Event caused that failure. Examples listed below may be outside Concessionaire control. However, ‘outside Concessionaire control’ is not the appropriate measure of whether an event should appear on the list to be contained in the Agreement. Many events ‘outside Concessionaire control’ at the time they occur could in fact have been prevented by proper precautions (e.g., fire). Therefore, the real question is whether the risk of specific events occurring, or the consequences of those events, ought to be borne by the Concessionaire since it is better positioned than the Authority to mitigate and manage the consequences through risk management and planning, which will also take into account insurance cover and the ability to work around events or the consequence of events.

Force Majeure Events may include the following:

- Fire, explosion, lightning, storm, tempest, flood, bursting or overflowing of water tanks, apparatus or pipes, ionizing radiation (to the extent it does not constitute a Force Majeure Event), earthquakes, riot and civil disturbances;
- Failure by any, utility company, local or regional authority, or other similar body to carry out works or provide services;
- Any accidental loss or damage to the Concessioned Assets;
- Any failure or shortage of power, fuel, or transport;
- Any blockade or embargo that does not constitute a Political Force Majeure Event; and
- Any labor disruptions, including the following:
 - official or unofficial strike;
 - lockout;
 - go-slow; or
 - other dispute,

However the Agreement should specify that ‘Force Majeure’ should not extend to events that arise directly or indirectly as a result of any default or act of the Concessionaire, any of its contractors or their sub-contractors.

It is not unusual for the Concessionaire to bear the financial effects of delays caused by Force Majeure Events, so the Authority would not compensate for the occurrence of such delays. If a Force Majeure Event occurs prior to the date for completion of the New Upgrades then any long-stop termination date will be put back by a period equal to the relevant delay caused by the Force Majeure Event. In most cases, the relief given will be limited to relief from termination and the payment of compensation to the Authority for delay, where this is provided for in the Agreement.

Typically, there should be no extension to the Term owing to a Force Majeure Event. However, consequences to the Concessionaire are that it must bear all losses that arise without recourse to others, except and to the extent that it can recover

under insurance, which may increase the losses because the Concessionaire's insurance premia are likely to rise in subsequent years.

The Agreement should provide that when a Force Majeure Event has occurred and the Authority has been informed, the parties should consult to discuss relevant issues, such as the likely duration of the Force Majeure Event and actions to be taken to mitigate the effects.

In some jurisdictions, courts can intervene and change contract provisions to adjust the economic equilibrium, or because the Concessionaire is meeting a public service obligation, to realign Concessionaire position with what it would have been without the event. Thus, in those jurisdictions where the Agreement seeks to allocate risk in the occurrence of a Force Majeure Event, the courts might override Agreement provisions.

Political force majeure events

Political Force Majeure provisions aim to protect the Concessionaire from the occurrence of the event on the basis that the event is out of Concessionaire control, and if the event exceeds a specified period, to afford the parties an opportunity to terminate either or both the Term and the Agreement. Political Force Majeure Events may include:

- War, civil war, armed conflict, or terrorism; or
- Nuclear, chemical or biological contamination, unless the source or cause of contamination is [the result of actions of the Contractor]; or
- Pressure waves caused by devices travelling at supersonic speeds.

Relief for Political Force Majeure Events would normally apply only to the extent that the Concessionaire or the Authority is unable to comply with all or a material part of its obligations under the Agreement and the parties cannot agree within a specified number of months how to restart the scheme in full.

The Authority should not be automatically obliged to pay the Concessionaire any sums simply to service Concessionaire loan obligations in whole or in part. The parties should recognize that the Concessionaire is likely to require some financial support as there is unlikely to be insurance cover available to cover these risks. The Authority may wish to bear in mind that in the event of Termination, the Authority would pay as a minimum, the outstanding Senior Debt, which would result in the loss of any outstanding subordinated debt to the Authority. Thus, both parties benefit if the full scheme can be reinstated through some temporary financial support from the Authority.

On the occurrence of a Political Force Majeure Event, the parties should consult to seek ways to continue the concession, for example, reaching agreement on how assets, if destroyed, can be reinstated; although neither party will be obliged to do this. The solution will depend on the nature of the event and its effects, but may involve altering Concessionaire obligations, adjusting or creating payment mechanisms, or extending the Term.

As indicated in section 2.14 above, the Concessionaire may be obliged to take out insurance for advance loss of profit or business interruption against Force Majeure Events so as to provide a replacement revenue stream for Funders and others whilst the income stream under, or by virtue of the scheme is impaired. Those insurances will not come into force until a stipulated number of days has passed so occurrence of any such event may still involve the Concessionaire in otherwise unrecovered losses. In addition, business interruption cover will not extend to all Force Majeure Events, and is usually parasitic in so far as there will need to be physical damage to the Concessioned Assets.

An alternative is to categorize intervening events as Insurable or Non insurable Events; however, there is an argument against this approach. The primary factor in allocating risk is deciding which party is best placed to manage the risk and its consequences and, in the case of Force Majeure Events, this is the Concessionaire. Therefore, the Concessionaire must decide how to manage the risk of the event and its consequences. The problem with this argument arises when Force Majeure Events are considered outside of an OECD economy. In countries where a risk is uninsurable in the market at commercially viable rates, other than through the act or neglect of the Concessionaire, the Authority may have to accept some financial risk for an uninsurable event that has occurred through no fault of the Concessionaire or its contractors and their sub-contractors, particularly where the service required under the concession meets a public service obligation, and the host country economy would be adversely affected if those services cease to be available either in whole or in a substantial part.

2.17 *Change in Relevant Taxes*

It is reasonable for the Authority to acknowledge that the concession and the Concessionaire's performance of its obligations are based upon assumptions concerning application and rates of Relevant Taxes to be borne by the Concessionaire.

If, after the date of execution of the Agreement, as a result of any application of Relevant Taxes (arrived at by reference to the host country tax regime) the Concessionaire was to become obliged to pay, or commences indirectly to bear any Relevant Taxes that did not exist or were not applicable to the Concessionaire at the date of the Agreement, or if the Concessionaire were to incur any increase in cost because the rate subsequently increased of any Relevant Taxes that the Concessionaire would be obliged to pay, or to indirectly bear, and if the Concessionaire is unable to obtain a compensating adjustment to any tariffs fixed by the Transport Regulatory Board, then the Concessionaire should provide the Authority with full details of any Change in Relevant Taxes as soon as practicable after it becomes aware of it, including the amount of tax and due dates for any payments.

The method of dealing with the Change in Relevant Taxes will depend upon host country tax law. The Concessionaire could be exempted by an extra statutory exemption, provided that it is legally binding on the tax authorities. Otherwise the Authority should hold the Concessionaire harmless, including by making compensatory payments.

In some case, these types of provisions require the effect of a Relevant Change in tax to reach a particular financial threshold before the compensation regime locks

in; in other cases, the provisions in the Agreement will allow a tax reduction to benefit the Authority.

2.18 *Change in Circumstances*

For the purposes of this Guide, a Change in Circumstances is defined as a significant change in the assumptions and conditions upon which the parties based their decision to enter into the Agreement, that is, either unforeseeable circumstances, or circumstances whose consequences were unforeseeable at the date of execution of the Agreement. The change can be further defined as one that was not caused by, or contributed to by, any act or default of any party, and in respect of which, had the parties been aware prior to the execution of the Agreement that such Change in Circumstances would arise, they would not have entered into the Agreement. The basis for that being that such Change in Circumstances would have adversely affected the relevant party's ability to carry out its obligations and duties under the Agreement, or would have adversely affected the financial equilibrium under the concession. Preferably, Change in Circumstances should include only those events similar to the following for which the Authority is responsible, such as Change in Law, acts of expropriation, compulsory acquisition, and nationalization.

In some jurisdictions the civil code will incorporate protections against these kinds of changes. For instance to be considered within a Change in Law, the change may be required to be material and satisfy the following criteria:

- It is generally inapplicable to commercial and industrial undertakings in the host country in which there is private investment or ownership.
- It imposes costs on the Concessionaire that exceed the value of any benefits to the Concessionaire; the change carries a discounted present cost to the Concessionaire over the remainder of the Term that exceeds a specified sum.

One solution to a Change in Circumstances is for the parties, at their own cost, to take all steps reasonably required to restore their ability to perform their obligations under this Agreement that are affected by a Change in Circumstances, and to continue to perform their respective obligations under the Agreement insofar as they are not so affected.

The Agreement may provide that within an agreed period following the occurrence of a Change in Circumstances, the parties should meet and should, following an agreed period for consultation, take adequate measures to restore the following:

- Ability of the relevant party to carry out its obligations and duties affected by the Change in Circumstances; and
- Financial Balance of the Concessionaire, keeping in mind the caution expressed earlier regarding the use of a financial model.

In the event that the parties fail to reach an agreement within the stated period, the Agreement might provide for submission to the Disputes Resolution Procedure (see section 2.30). However if the following conditions emerge:

- The occurrence of a Change in Circumstances continues for a specified period, or
- A series of related Changes in Circumstances continue in the aggregate for that specified period during any year,

...the Agreement might then provide that the Concessionaire can opt to terminate the Term when the specified period expires by delivering a Termination Notice to the Authority. Upon such termination, provisions relating to termination should apply (see section 2.24).

2.19 Variations

The structure of the Agreement risks rigidity if it does not allow for Variations, which would normally fall into two categories. In the first category, the Concessionaire wishes to change the Concessioned Assets or a New Upgrade or Future Upgrade during the period of construction or fabrication; the second category include variations by which the Authority is seeking a change.

In either case, the Agreement should include provisions for giving notices, and counter-notices. In a Variation proposed by the Authority, the Concessionaire should be able to reject a request for a change if the Variation would affect safety or operability. The Authority may be concerned if the Variation could impose additional financial costs, e.g., increase compensation amounts payable on expiry of the Term (or earlier termination) or might reduce the benefits of services to be rendered under the Agreement.

The costs of a Variation should, by and large, be borne by the party requesting the change. If extra costs can be recovered through additional Track Access Charges or similar, the main issue will be securing funds to cover the initial costs.

2.20 Preservation of the Concessioned Assets

Typically, common business provisions include the following:

- In most cases, the railway will be run as a going concern, which will require arrangements with third parties that transcend the Expiry Date of the Term. Any third-party contract that requires the third party to make payments to the Concessionaire should be structured so that the Authority will receive the same benefits pro rata as the Concessionaire. Thus, contracts should not seek front-loaded payments, nor should they seek to impose any back-loaded obligations that might place the Authority at a disadvantage. In addition, no contract should be let that conflicts with the Expiry Date within a specified period of that date without the consent of the Authority.
- As the Expiry Date approaches, the Authority's interest will heighten in the maintenance of any concessioned asset. The Agreement should specify the condition of the Concessioned Assets both during the Term and on Hand Back and set out the Concessionaire's obligations in that respect. The Agreement should also provide that the Authority will inform the Concessionaire of its handover requirements not less than a specified number of months prior to

the Expiry Date. The Authority's interest will increase when it has to pay compensation to the Concessionaire on expiry of the Term, whether under the terms of the Agreement, under the terms of a further agreement to that effect in relation to Future Upgrades, or under the law of the host country.

- If the Authority receives the Concessioned Assets at the end of the Term, which is the common scenario, any maintenance obligations will need to be monitored, and a mechanism established to accomplish this in a manner that is as non intrusive as possible.
- If the Authority reasonably believes that the Concessionaire is in breach of renewal and maintenance obligations under the Agreement, then the Authority should be permitted to carry out, or procure, a survey of the Concessioned Assets to evaluate whether the Concessionaire has been and is renewing and maintaining the assets in accordance with its Agreement obligations. This right may be restricted to being exercised not more than once during a specified number of years.
- Where the Authority wishes to carry out a survey, it should notify the Concessionaire in writing an agreed minimum number of days in advance of the date on which it wishes to carry out the survey. The Authority should consider any reasonable Concessionaire request for the survey to be carried out on a different date. When carrying out any survey, the Authority should exercise or procure the exercise of reasonable efforts to minimize any disruption caused to the Concessionaire. Survey costs should be borne by the Authority, except where the survey results reveal Concessionaire failure, in which case, the Concessionaire should bear survey costs; or unless the surveys are related to Hand Back. The Concessionaire should be required to give the Authority, without charge, any reasonable assistance required by the Authority during the conduct of any survey.
- If the survey reveals that the Concessionaire has not complied with its renewal and maintenance obligations, the Authority is likely to require the powers to do the following:
 - Notify the Concessionaire of required standards for the condition of the Concessioned Assets to comply with Agreement obligations; and
 - Specify a reasonable period within which the Concessionaire must achieve compliance through rectification and/or maintenance work.
- The Concessionaire should be required to carry out such rectification and/or maintenance work within the period specified, and bear fully any costs incurred in rectification and/or maintenance work.
- For Hand-Back surveys, it is reasonable for survey costs to be borne jointly; if the Concessionaire so requires, surveys should be carried out by an independent expert agreed between the parties. In case of failure to agree, the Agreement should name a nominating body to appoint the independent expert. If the survey finds that renewal and maintenance work is needed to bring the

Concessioned Assets up to the standard required under the Agreement, the Concessionaire should issue a bond according to section 2.12, or establish an escrow account and deposit an amount equal to the estimated cost of carrying out the renewal and maintenance work.

In case of a failure to deliver a service as part of the concession, particularly if the service is to meet a public service obligation, the Authority may require a temporary right to procure the operation of all or part of the Concessioned Assets. The Agreement provision should include protocols for serving 'notice of intent' to assume operations, assignments of responsibility for costs incurred, and allocations of risk, particularly in relation to any damage incurred to Concessioned Assets during operation, and the withdrawal of the Authority, or its nominee, at the end of the emergency period.

2.21 Confidential Information

It is better to start with the concept of transparency and to require the Concessionaire to divulge information that might reasonably be required for informing the public of the progress or otherwise in improving services. The scope of such disclosure can be dealt with under section 2.23 (Reporting and Records). That said, in many agreements, 'Confidential Information' refers to any information, data or other matter ('information') disclosed to a party by, or on behalf of, another party under the following conditions:

- Disclosure of the information by the recipient might be reasonably expected to affect the commercial affairs of the owner of the Confidential Information; or
- Information is marked 'confidential' by a party when disclosed, and provided further that information will cease to be Confidential Information if the information has ceased to retain its confidential nature, for example:
 - Information disclosed by the recipient would no longer be reasonably expected to affect the commercial affairs of the information owner;
 - Information is now in the public domain through means other than a breach of the confidentiality provisions in the agreement;
 - Information reached the recipient independently, from a third party free to disclose the information.

Unless host country law specifically provides, consideration should be given to provisions that extend confidentiality to Track Access Holders and Track Access Applicants. The definition of Confidential Information would include information or data collected by the Concessionaire or a Track Access Holder in the performance of an Access Agreement as in the following circumstances.

- If the collector discloses information that might be reasonably expected to affect the commercial affairs of the other party to the Access Agreement;
- That the other party shall be deemed to be the owner of such Confidential Information.

The parties would agree to maintain confidentiality except in respect of Permitted Release referred to below, and the Concessionaire would be required to enter into confidentiality undertakings with Track Access Holders and Track Access Applicants.

Permitted Release could include the following examples:

- Disclosure is required or compelled by any law;
- Disclosure is necessary for the conduct of any legal proceedings, including any dispute resolution process under the Agreement or the Track Access Agreement;
- Disclosure is required under any stock exchange listing requirement or rule;
- Disclosure is to the Rail Safety Board;
- Disclosure is to the recipient's lawyers, or accountants under a duty of confidentiality;
- Disclosure is to the recipient's banker or other financial institution, to the extent required for the purpose of raising funds or maintaining compliance with credit arrangements, if such banker or financial institution has executed a legally enforceable confidentiality deed in favor of the owner of the Confidential Information;
- Disclosure is for the purpose of facilitating train control directions where the disclosure of information is by the Concessionaire in the usual course of undertaking train control;
- Disclosure is by any person involved in clearing an incident or emergency that is preventing the operation of Train Services on the Rail Infrastructure;
- Disclosure is to an infrastructure provider or operator for infrastructure forming part of the system in respect of which Access forms a part.

A particular issue arises where the Concessionaire operates the Below Rail Infrastructure and is a Rail Freight Operator. If Concessionaire employees transfer from infrastructure operations to freight operations, it is important to ensure that they do not use the Confidential Information obtained about Track Access Holders and Track Access Applicants in their new position, and that the Concessionaire gives specific undertakings in that respect.

2.22 *Employees*

If real reform of the railways is to be achieved then this is likely to require a comprehensive change to the terms and conditions on which railway employees are employed and the manner in which they carry out their duties including the removal of restrictive practices. If existing personnel are to be transferred to the Concessionaire, one option is for the Concessionaire to stipulate the number of trans-

ferred personnel in its bid documents, and under the Agreement the Concessionaire agrees to employ that number. Before the commencement of the Term, the Concessionaire should select and identify employees to the Authority.

It would be reasonable to include a provision to encourage the Concessionaire to use local personnel and to require that selection of local staff should give preference to existing rail employees, subject to suitability, qualifications, and availability. If the Concessionaire demonstrates that existing rail employees are unsuitable or insufficiently qualified, then the Concessionaire should be free to recruit employees with specific skills from other sources.

Each transferring employee would enter into an employment contract with the Concessionaire. Issues such as accrued pension rights and other employee benefits will need to be addressed; the extent to which it would be economically sensible or feasible to maintain conditions that are at least equal to the terms and conditions enjoyed with the former rail employer prior to the commencement of the Term will depend upon what those terms were.

The Authority may require the Concessionaire to employ or procure the employment of competent local labor, to the extent available, to construct the New Upgrades and to operate, renew, and maintain the Concessional Assets.

2.23 Reporting and Records

If the Authority grants a subordinated loan, any subordinated loan documentation will entitle the Authority to receive comprehensive financial and management information but that entitlement will end when the debt is discharged.

Thus it is suggested that the Authority should set out its rights to information in the Agreement. Where the Authority is to repay loans to Funders, no matter the grounds for termination, the Authority is likely to require more information to enable it to monitor its exposure. Further, where the Authority or the state makes temporary funds available due to disturbance in the lending market, the Authority may require a greater influence over the choice of management in the event that the concession gets into difficulty.

Prior to the commencement of the Term, the Authority and the Concessionaire should agree on the format for quarterly reports. By a date certain in the third month after the commencement of the Term and every three (3) months thereafter, the Concessionaire should submit to the Authority, a report in the agreed form. The report might reasonably cover progress in the development, financing, construction, and commissioning of the New Upgrades and the renewal, maintenance and operation of the Below Rail Infrastructure. Similarly, the report might provide details of main railway activities during the period—volume of traffic, changes in traffic or activity from the previous period, and for the same period during the preceding year, fees, revenues, expenditures, and other key metrics data.

The Concessionaire could reasonably be required to carry on its business and affairs with due diligence and efficiency, in accordance with sound international financial and commercial standards and practices, and fully account for all aspects of its business as follows:

- The Concessionaire should prepare and submit to the Authority within a specified number of months of the end of each financial year a copy of the Concessionaire's audited financial statements that have been or are to be submitted to state tax authorities and that have been drawn up by an internationally recognized accounting/auditor firm registered in the host country in accordance with international accounting standards and host country laws. Financial statements would include balance sheet, profit and loss account, and cash flow statement, together with any explanatory notes or variations from international accounting standards used to comply with host country law.
- In addition to financial statements, the annual reporting to the Authority might include the following information and metrics.
 - Freight tons, ton-km, passengers and passenger-km carried;
 - Locomotive-km for passenger and freight service;
 - Freight ton-km per employee and passenger-km per employee;
 - Revenue and costs by service or activity;
 - Actual vs. planned maintenance and details of asset breakdowns that have affected services;
 - Summary of events and causes of cancellations and late running, together with complaints received and actions taken and summaries of user satisfaction surveys;
 - Summary of accidents and incidents, causation and consequences (serious accidents should have been reported to the relevant Ministry as soon as they occurred and would be an issue for the Safety Board);
 - Details of human resources programs including personnel employed and training provided;
 - Rolling stock utilization statistics for both Concessionaire and other Track Access Holders.
- The Authority may wish, at its own expense, to appoint an independent auditor registered in the host country to verify Concessionaire statements and information. The Concessionaire should provide all reasonable assistance to the appointed auditor.

The Agreement should also specify any other reports and records that the Authority may require.

The Agreement should identify required periods for retaining categories of records, and expectations for these at the time of Hand Back.

2.24 Termination

Termination by authority for concessionaire's default

Funders and investors will need certainty about circumstances under which the Term or the Agreement (depending upon the approach adopted) may be terminated. This is even more critical if termination due to a Concessionaire's Default would lead to loss of equity investment and a loss of all or part of the debt. Therefore, the Agreement should set out a list of potential events of Concessionaire Default that could give rise to Termination if such events remained unremedied, or for which no remedy exists. Of course, there are 'Intervening Events', for which the Concessionaire is relieved of liability, where termination for default would not arise, nor would it arise if the Default was caused by an act or neglect of the Authority. Examples of events of Default may include:

- Failure of Concessionaire to complete the New Upgrades by the Back Stop Date;
- Abandonment by Concessionaire of performance of its obligations;
- Failure to comply with agreed levels of service under the Agreement;
- Failure to pay Concession Fees to the Authority as they fall due;
- Insolvency and other similar events;
- Acts of corruption: However, the Concessionaire should be given an opportunity to dismiss personnel or contractors involved in the corrupt practices if the Concessionaire's management were unaware of the acts;
- Save as may be permitted by the Agreement, the assignment or transfer of any of Concessionaire rights or obligations in relation to the Agreement;
- Any material breach by the Concessionaire of any its obligations under the Agreement;

Termination by concessionaire for authority's default

The Authority will need to appreciate that the Agreement will impose obligations on it and the Concessionaire will rely upon the performance by the Authority of those obligations. Common breaches by Authorities have included failure to make concession support payments, failure to release assets when contracted to do so and the like. Further, where either or both receivables are to be adjusted for inflation and funding is expressed in currency other than that of the host country and receivables are to be adjusted for currency fluctuations then any interventions by the Authority to prevent this from happening will have a serious adverse effect.

Therefore, the Agreement should also list the events that should constitute ‘Authority Default, on a basis similar to that relating to the Concessionaire. The list may include the following:

- Expropriation, compulsory acquisition, or nationalization by the Authority of the Concessionaire or the rights of the Concessionaire under the Agreement;
- Removal of a consent required for the Concessionaire to perform under the Agreement ;and
- Any material breach by the Authority of any of its obligations under the Agreement, after notice from the Concessionaire, giving reasonable details of the breach and demanding remedy thereof.

Termination for non default

The Agreement should provide for termination in the event of prolonged Force Majeure or where the parties are unable to reach an agreement on the occurrence of an event of Political Force Majeure. (As indicated earlier, in some jurisdictions, courts may, through legislation, impose a solution on the parties.

Termination procedure

The party seeking termination should serve Notice of Intent to Terminate and set out the grounds on which it seeks to terminate. If grounds are based on an event of default that can be remedied, then the defaulting party should be given an opportunity to do so, or to put forward a program to do so. Specific time periods for each step should be set out in the Agreement.

Following the delivery of a Notice of Intent to Terminate, if the default has not been remedied or a program for remedy agreed upon, then the Non Defaulting Party that served the notice should be permitted to serve a Termination Notice

Effectiveness of a termination notice

The Agreement should state the minimum time period between service of the Termination Notice and the Date of Termination.

Other remedies

The exercise of the right of a Non Defaulting Party to terminate the Agreement should not preclude that Party from exercising other remedies provided under the Agreement. However, the Agreement will often include an ‘exclusive remedies’ clause that will limit the right of either party to remedies under the Agreement, rather than generally at law, and there may well be exclusions for what are sometimes loosely referred to as ‘consequential losses’ but might better be referred to as ‘indirect losses’, including opportunity costs.

Rights and obligations on termination

There are two approaches to termination. First, termination can occur under the Agreement, in which case those provisions that are to remain in effect, such as Confidentiality, Dispute Resolution, and provisions relating to post termination financial adjustment, such as compensation payments must be listed. Second, ter-

mination can occur because the Term under the Agreement expires or is prematurely reached. In this case, the obligations of the parties are abolished in relation to the concession, but remaining obligations stay in force. The approach will in part be impacted by host country law.

Post termination

The Concessionaire should release control of Concessioned Assets in accordance with the Hand Back procedure, unless and to the extent that it is intended, that the Concessionaire may keep certain assets. Whether the Concessionaire should receive compensation, in what circumstances and how much, will depend on what the market will accept at the time of bidding for the concession, and the law of the host country.

In essence if termination is due to Authority Default, compensation should be sufficient to repay Funders, including all unwinding costs, repay equity capital, pay the unwinding costs of then-existing contracts, the costs of demobilization and a payment towards future dividends on shares lost as a consequence of early termination.

Where the Concessionaire is in default, a practical measure would be to offer the residue of the concession on the same terms as the original concession and, after payment of the Authority's expenses, to pay the balance to the Funders of the Concessionaire. This works only where there is a liquid market—a sufficient number of companies willing to bid for the replacement concession and sufficient Funders prepared to lend money. The worst position for the Authority is that it must pay off Funders in full, plus part of the equity or share capital. A midway position is possible in jurisdictions that allow an entitlement to compensation if the concession relates to a public service. The courts will establish compensation if it was not agreed between the parties, although this will not reassure Funders, because the process of resolving disputes on value at law is typically prolonged.

On the occurrence of an event of Political Force Majeure the Concessionaire would expect repayment of Funders, return of equity, and costs of demobilization.

On Force Majeure, the Concessionaire would argue, as a minimum, for repayment of debt although it does not succeed in all jurisdictions. See issue of power of the courts in section 2.16 under the reference to Force Majeure.

Expiry of term

On Expiry of Term, the Concessionaire should surrender the concession, release control of the Concessioned Assets to the Authority, and at the option of the Authority, sell to the Authority other of the Concessionaire's assets.

2.25 Hand Back

There are various methods of effecting Hand Back; some of these reflect the nature of the concession granted, such as whether ownership transfer occurs at the end of the Term or when Concessioned Assets are created. Hand Back is greatly influenced by host country insolvency law and whether, if the Concessionaire were to be insolvent, the assets can be retained or obtained to carry on meeting the public service obligation, if such obligation exists. Whatever the legal mechanism

adopted, it is suggested that within a stated period or other time period agreed by the parties, of the inspection carried out under section 2.20, the parties should meet and agree on the processes based upon the Hand Back Procedure. The headings for these items should appear as a schedule to the Agreement, and might comprise the following.

- Works to be carried out to ensure that Concessioned Assets comply with requirements on the Hand Back Date;
- Subsisting contracts and whether they are to be cancelled or assigned to the Authority;
- Inventory of items included in the scope of Hand Back Assets;
- All the Concessionaire's assets and details on whether such assets are to be removed or transferred to the Authority, and the terms of such transfer in accordance with the respective terms and conditions of terminations under the Agreement;
- Employment, transfer or redundancy of employees;
- Training and testing procedures for personnel designated by the Authority to ensure the independent operation of the Concessioned Assets by the Authority;
- Concessionaire's rights and obligations that expressly survive termination or expiration of the Term;
- Any other details and procedures in respect of the scope of Hand Back.

Scope of hand back

On the Hand Back Date, in accordance with the Hand Back Procedure, the Concessionaire should release or transfer to the Authority the following:

- All of the Concessionaire's rights, title and interest in the Hand Back Assets, free and clear of encumbrances and claims of whatever kind or nature;
- All Concessionaire rights to use, possess, or access Concessioned Assets;
- All operation and maintenance manuals, design drawings, and other information as may be reasonably necessary, or as may be reasonably requested by the Authority to enable it or its designee to continue operation of the Concessioned Assets;
- All unexpired guarantees and warranties from sub-contractors and suppliers, and all insurance policies including claims, awards, and adjustments;
- Individual and collective employment agreements, medical and pension schemes, and other labor relations obligations;

- All technology and know-how related to operation and maintenance of the Concessioned Assets as may be necessary to enable the Authority or its designee to continue to operate Concessioned Assets.

Other hand back issues

The Concessionaire should cancel or assign to the Authority, as set out in the Hand Back Procedure, any operation and maintenance, equipment, supply or service agreements and any other agreements held by the Concessionaire and subsisting at the time of the Hand Back Date.

The Authority ought not to be liable for any cancellation costs arising thereby, and therefore should be indemnified and held harmless by the Concessionaire in respect of the same.

The Concessionaire, at its own cost and within a specified number of days after the Hand Back Date, might reasonably be required to remove, or take reasonable steps to remove, all those assets non transferrable to the Authority.

Remedy of defects after the hand back date

If, within a specified number of days of the Hand Back Date, the Concessionaire fails to comply with or complete any item of the Hand Back Procedure, then within a further specified number of days of the Hand Back Date, the Authority will require a remedy and therefore should be entitled to give notice detailing the Hand Back Failure, and requiring the Concessionaire to remedy the failure within a reasonable specified time. The Concessionaire should at its own cost, remedy the Hand Back Failures.

If the Concessionaire refuses or otherwise fails to remedy the Hand Back Failure within the specified time, the Authority itself should be entitled to remedy the Hand Back Failure, and to recover costs and expenses from the Concessionaire, whether under the bond or otherwise.

Due diligence as part of the performance studies will reveal the incidence of transfer fees and charges including stamp duty, registration fees, transfer tax, and the like. The Agreement should stipulate who should bear these.

2.26 Assignment and Other Dealings

Over the course of a long-term contract, the identity of the Authority, the Concessionaire, or the Funders may change to some extent. The shares in the Concessionaire may be bought and sold, loans may be refinanced, or Funders may syndicate, sub-participate, or create derivatives out of existing loans. Each of these steps may impact upon the other parties and change the commercial and other pressures that might be assumed to have existed at commencement of the Term. This should be recognized at the time of negotiating the Agreement, and an appropriate balance struck that allows some flexibility for any appropriate changes, but provides the parties with sufficient comfort about the identity and/or creditworthiness of their counterparties.

Restrictions on the concessionaire

The Agreement should not allow the Concessionaire to assign, novate, or transfer its rights under the Agreement, except as part of the Senior Lenders' security package. If a replacement Concessionaire is appointed by the Senior Lenders, where they have such rights under a direct agreement between the Authority, the Funders, or the Funders' agent and the Concessionaire, then the Agreement should permit the original Concessionaire's rights and obligations to be transferred. Further, restrictions may exist to shareholders' rights to dispose of shares or any economic interest in shares; such restrictions may stipulate a period of time, or stipulate conditions that might bring about a change in control. Where it is appropriate to include such a provision in the Agreement, then the wording and thus the restriction must extend to any beneficial or other economic interest in those shares, and may need to embrace ultimate or intermediate holding companies and subsidiaries of the Concessionaire, particularly where the subsidiaries are carrying out a major function in relation to the concession.

Restrictions on the authority

Bearing in mind the importance of Authority financial strength, it is reasonable for the Agreement to disallow the Authority to assign or transfer its rights or obligations under the Agreement without Concessionaire consent, except if transfer takes place under legislation or is required to facilitate public sector reorganization. However the creditworthiness of the public sector party must not be damaged as a consequence.

Changes in financing

It may be that if the Concessionaire can refinance at lower rates, the potential gain in profitability will be counterbalanced by the Transport Regulatory Commission, which could reduce the tariffs otherwise payable to the Concessionaire. If the host country's law renders this unlikely, then the Authority should consider whether it should share benefits of refinancing gains. Very careful drafting will be required if issues become more complex, for example, that refinancing gains could be taken at a higher level, e.g., at a holding company level.

In addition, if the Authority is commercially, as opposed to contractually, relying upon Senior Lenders to act as a controlling influence on the Concessionaire, because Senior Lenders will be paid only to the extent that the Concessionaire performs, then the whole issue of syndication, sub-participation, and particularly the creation of derivatives, needs to be considered.

2.27 Intellectual Property Rights

To be able to operate the Concessioned Assets under emergency circumstances, or on expiry or termination of the Term, the Concessionaire should grant to the Authority an irrevocable license or sub-license to use the intellectual property rights relating to the renewal, maintenance, or operation of those assets. The Authority should itself be permitted to grant sub-licenses to subsequent Concessionaires or operators.

If the Concessionaire is also a train operator, the Authority may require licenses to use processes for operational systems used in the delivery of freight services. If this is proprietary software, then following expiry or termination of the Term, it is likely

for those processes to be required until a new Concessionaire or operator has been appointed, and has had an opportunity to introduce its own systems.

2.28 *Payments*

Provision should be made for payments and timing of payments, such as when they would otherwise fall due on a public or banking holiday.

In the event of a failure to make payment by the due date, compensation should be paid. The Concessionaire will be borrowing funds; any interest payable to the Concessionaire should represent its costs for lack of punctual payment. However, the rate of compensation should not be such that the Concessionaire has an incentive to delay paying the Authority because compensation represents a cheaper alternative under the Agreement than borrowing. Thus the rate of interest for late payment should be linked to fluctuating costs for funds.

2.29 *Proper Law and Language*

In most Host Countries it is accepted that the law controlling the Agreement will be the law of the host country.

As to the language, the costs of international bidders and their Funders will be substantially reduced if translations are not required; therefore English, French or Spanish have advantages; typically, English is the most universal. However there may be political or cultural reasons that this is unacceptable.

2.30 *Dispute Resolution*

Except and to the extent that economic, standard-of-service, or safety issues may be dealt with under law by a regulator, in effect, there are three main ways of resolving disputes arising under the Agreement, namely expert determination, arbitration, and litigation. Whether two out of three ought to be used depends upon host country law. In some jurisdictions, no mechanisms exist to recognize an expert determination as final, binding, and enforceable. In other jurisdictions, the courts will intervene in arbitration, or when registering an award for enforcement the courts will accept a rehearing of the issues. In some jurisdictions, concessions will fall within administrative law; therefore, disputes arising under or in connection with the Agreement would have to be referred to the Administrative Courts.

Among reasons *not* to use the courts is the caliber of the judiciary. Concessions are complex, as are the agreements relating to granting them. There is a risk that the judiciary will not fully understand commercial and other issues involved; or there could be corruption within the court system, delays in processes and hearings, and the risk of numerous appeals. Another key issue is how long it may take to go through levels of the courts to reach a final decision.

The Concessionaire and its Funders will want to determine whether potential exists in the host country for the Concessionaire to apply for a judicial review in circumstances where the regulator makes a decision that would adversely affect the Concessionaire, and the decision is deemed unreasonable.

International investors and Funders will be influenced by the potential for satisfactory dispute resolution through arbitration. Therefore whether the host country is a signatory to the New York Convention on the Enforcement of Foreign Arbitral Awards, ICSID (International Center for Settlement of Investment Disputes) or other regional conventions becomes important.

As a condition precedent to launching any dispute proceedings, it may be useful to require a meeting between the Authority senior administrator and the Concessionaire chief executive officer who should be given a short period of time to resolve the issue. At a minimum, the requirement to meet ensures that senior officers must seek to understand the issues and the approach of their counterparts before embarking on an expensive dispute. As a corollary to this requirement, pre-reform process training within the Authority needs to emphasize that administrators should take decisions proactively rather than hiding behind the pretext that the decision was forced upon the Authority because of a finding under the Disputes Resolution Procedure.

Expert determination, where this is an option, can be valuable in settling technical disputes, e.g., if the dispute relates to construction or operational issues. In some cases, a permanent disputes resolution panel has been established for the construction phase to expedite resolution of technical disputes during construction. In other cases, financial disputes have been referred to a panel of financial experts.

From the Authority's perspective, any disputes are strictly between itself and the Concessionaire, not involving third parties. From the Concessionaire's perspective, involving third parties such as its own contractors is advantageous, particularly if it seeks to pass its liabilities down to those contractors. However, if dispute resolution involves a three-person arbitration panel comprising one appointee from the Authority, one from the Concessionaire, and an umpire, a joiner of proceedings is impractical because contractors would not have a representative arbitrator. Therefore, if dispute resolution deals with more than two parties, a single arbitrator is the best solution.

2.31 Boilerplate

The Agreement will require several standard terms to address issues such as the service of notices, whether the Agreement represents the entire agreement or if there are a series of contracts, and a provision to preserve the Agreement in the event that a provision is found to be illegal, and the like.